
IFPSM World Summit

The Future of Supply Management

General Session Comments

Las Vegas, September 21, 2009

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Agenda

- Where we've come from
- Where we are
- Where we are going

Where we've come from

■ Up until 1985 – Purchasing was focused on Continuity

- First book specifically addressing purchasing – The Handling of Railway Supplies – Their Purchase and Disposition (1887) by Marshall M. Kirkman
- Early in the 20th Century more books and articles were published concerning purchasing practices as they related to specific industries – railways, manufacturing, mining
- In 1917, Harvard offered a course in purchasing. The first college textbook on purchasing was published in 1933 by Howard T. Lewis of Harvard
- During each of the World War periods purchasing became more important due to importance of keeping factories and mines operating – finding needed raw materials, supplies and services
- Until 1985, purchasing goals were to "obtain needed supplies for reasonable prices..."

Where we are

■ 1985 to present – Competitive Pricing added to Continuity objective

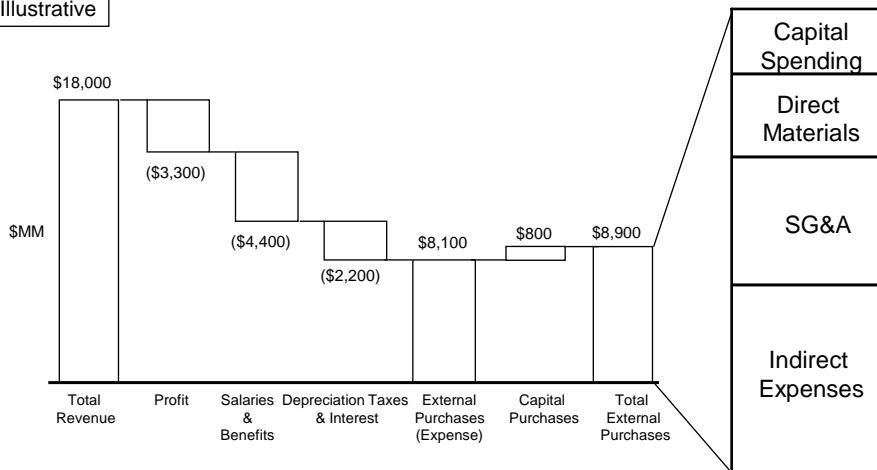
- More competitive costs
- More use of electronic tools
- More visibility to senior executives
- More “market share” for total external spend – more equal footing with internal stakeholders

The 1980's saw several factors coalesce to make sourcing strategic

- Capital became more available from more global sources
- Commodities shortages of the 1970's emphasized that a) supply availability and b) predictable costs could not be counted on.
- Corporate acquisitions became more hostile – less gentlemanly behavior amongst corporate executives
- Japanese production methods challenge conventional processes – manufacturing and services. "Reengineering" is popularized by Michael Hammer and others
- A few Corporate executives seek alternative suppliers to promote cost improvements
 - Jack Smith at Opel
 - Arthur Martinez at Sears
 - Jack Welch feels the sting

Originally, companies had to be convinced that they spent a lot

Illustrative



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Sourcing provided quicker results than process reengineering

Manufacturing Firms

Overhead
Indirect Labor
Direct Labor

20% To
40%

**Purchased
Materials
And
Services**

60% To
80%

Repeatedly attacked

- Reengineering
- Downsizing

**Under-exploited
opportunity**

Service Firms

Interest And
Overhead

Operating
Costs

**Purchased
Services And
Supplies**

50% To
70%

30% To
50%

Reengineering and Downsizing...

- Threatening
- Disruptive
- Counterproductive

Strategic Sourcing...

- Focused on external relationships
- Required some supplier changes
- Achieved savings faster

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Typically Senior Executives understood, but saw obstacles

- "If I only knew what we spent, I could go after it!"
 - Accounts payable historical records became the beginnings of spend cubes
 - Attempts were made to classify spend to link it with potential suppliers – some were too precise (UNSPSC), others were too general (technology, MRO). "Spend trees" were designed to match supplier marketplaces
- "Let's bring in our key suppliers and negotiate with them!"
 - Key suppliers often had no reason to offer price concessions, they have more power over their customer than vice versa. Alternative suppliers were determined. Five forces analyses were applied to supplier marketplaces.
- "This spend (key raw materials, marketing, technology) is too strategic. Why don't we start out with something less important (Office Supplies)?"
 - Key spend categories had highly-placed stakeholder executives who didn't want to upset their incumbent suppliers. Purchasing had to earn its way into these areas.
- "Even if I get the savings, how can I be sure it will hit the bottom line?"
 - Savings definitions were developed for each spend category. Approval processes were developed and authorized by finance. Tracking systems were developed. Savings were taken out of affected budgets.

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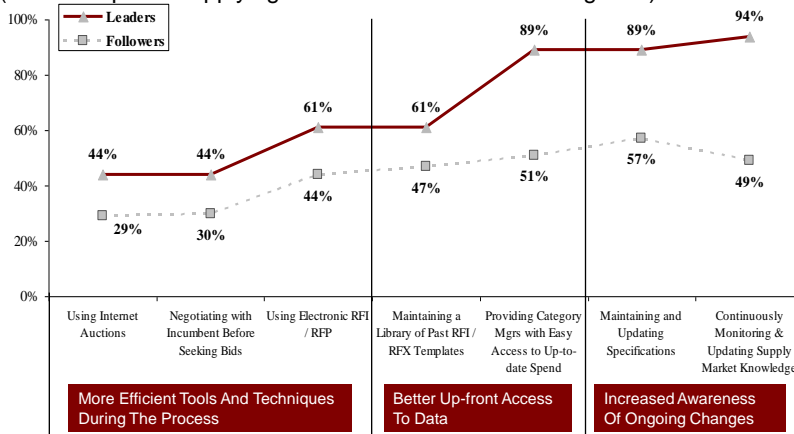
Purchasing executives saw different barriers

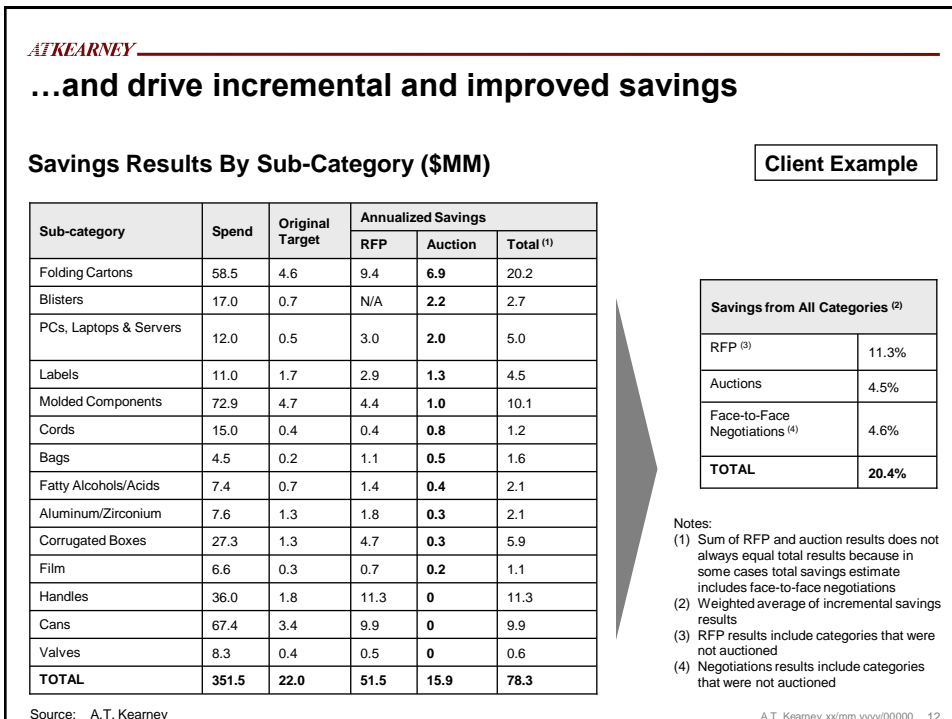
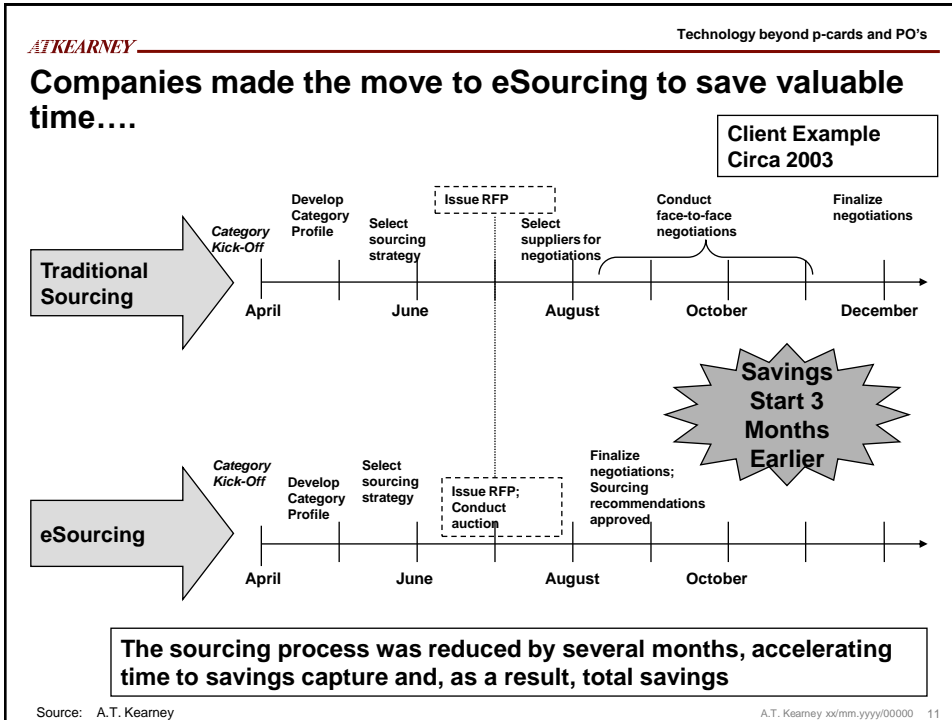
- "I can't challenge my (paper) supplier, they really saved my butt back when we were under supply allocation!"
 - In order to obtain cost reduction, availability had to be almost certain. They would get an "atta boy" for cost savings, they would get fired for shutting down production
- "If I save 12% in that category, what will I do for next year's budget?"
 - Cost savings can be obtained by addressing a portion of the spend each year."
- "Purchasing is never allowed to look at that category (raw materials, marketing, technology); we don't have any capabilities in those areas."
 - By starting with smaller segments of those categories (back-up suppliers, displays, lap-tops), purchasing can demonstrate capabilities that can be expanded into a larger "market share" or influence for their function.
- "We believe in total quality management, we can't live as a low-cost manufacturer!"
 - Savings are usually demonstrated from incumbent suppliers; you're buying from the same place, why would they lower quality. Then, better metrics are created for quality by the sourcing process, which further overcome the barriers, improve what is bought

Leaders systematically reduce sourcing cycle time to increase sourcing productivity

Approaches To Reduce Sourcing Cycle Time

(% of Companies Applying to Most or All Relevant Categories)



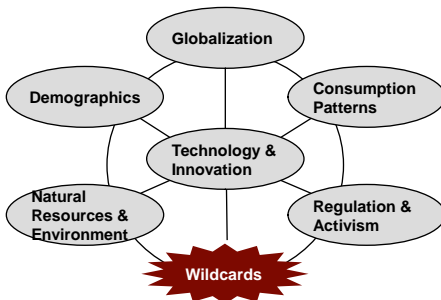


Where we are going

- 2010 and on
 - Dealing with the “new normal”
 - Continued emphasis on Cost competitiveness
 - Much more emphasis on Value creation
 - Increased debate about globalization coupled with continued commodity price fluctuations
 - Many will not be ready to deal with these difficult times

External and organizational forces will reshape supply management

Forces of Change



Business Models and Strategies

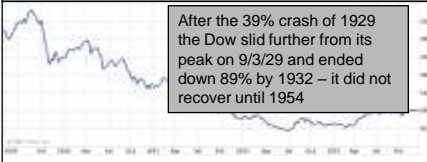
Income Statement	Balance Sheet
Revenue <ul style="list-style-type: none"> • Move up the value stream • Enrich customer relationships • Embrace emerging markets 	Fixed Assets <ul style="list-style-type: none"> • Reduce investment • Make assets more efficient, flexible and mobile
Cost <ul style="list-style-type: none"> • Address structural cost • Purse ongoing cost reduction 	Working Capital <ul style="list-style-type: none"> • Reduce requirements • Increase cash flow

Supply Mission Goals and Performance Expectations

More Innovation from Suppliers	Contributions to Revenue Generation
Supply Risk Mitigation	Expanded Cost Management

The 2008 financial crisis has wiped out more than \$20 trillion in equity value and has frozen credit markets

Stock Markets have Experienced the Sharpest Drop since The Great Depression



After the 39% crash of 1929 the Dow slid further from its peak on 9/3/29 and ended down 89% by 1932 – it did not recover until 1954

DJIA: From its peak on 10/9/07 (14,165), Dow fell 45% (to ~7,850), then rebounded to 9,500



Multitrillion Dollar Losses Mount and Prohibitively Expensive Credit Persists

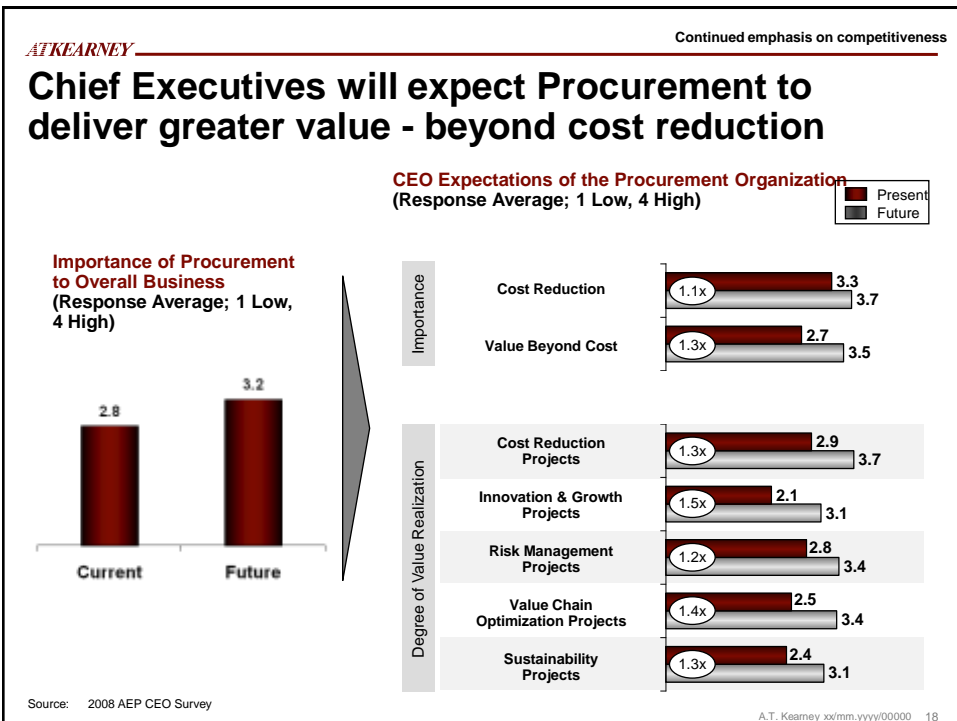
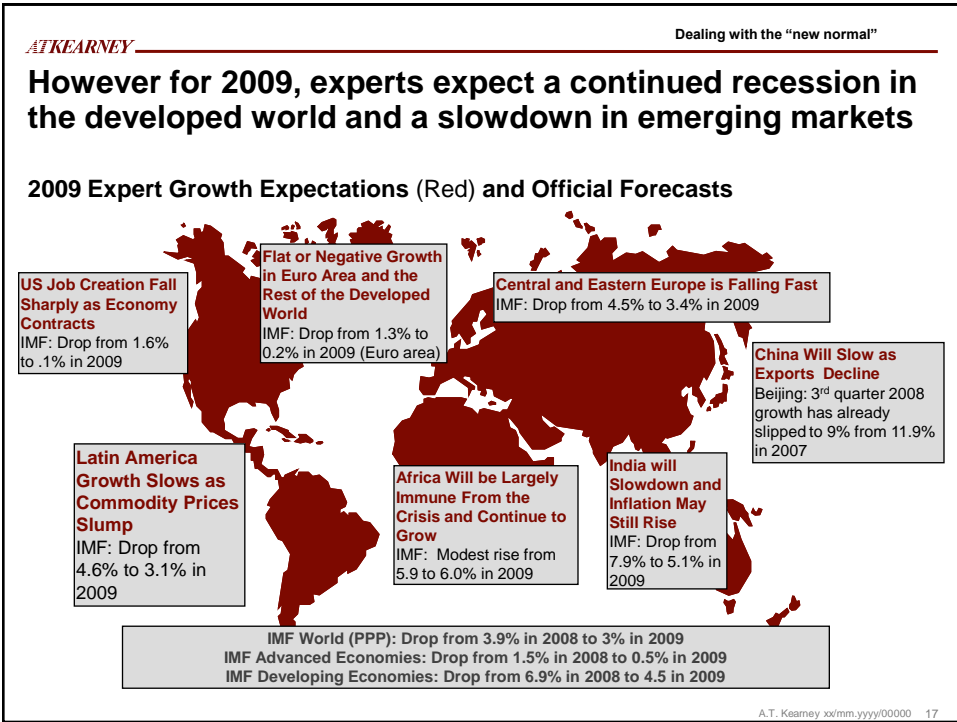
- **Losses in world stock markets are roughly \$20 trillion:** the MSCI World index has declined about 45% since the end of 2007
- **Financial institution losses mount:** Financial institutions' direct losses could reach \$3.6 trillion, requiring recapitalization on an unprecedented scale
- **Credit markets freeze:** due to loss of confidence, inter-banking lending has sharply declined creating illiquid credit markets and raising the cost of capital

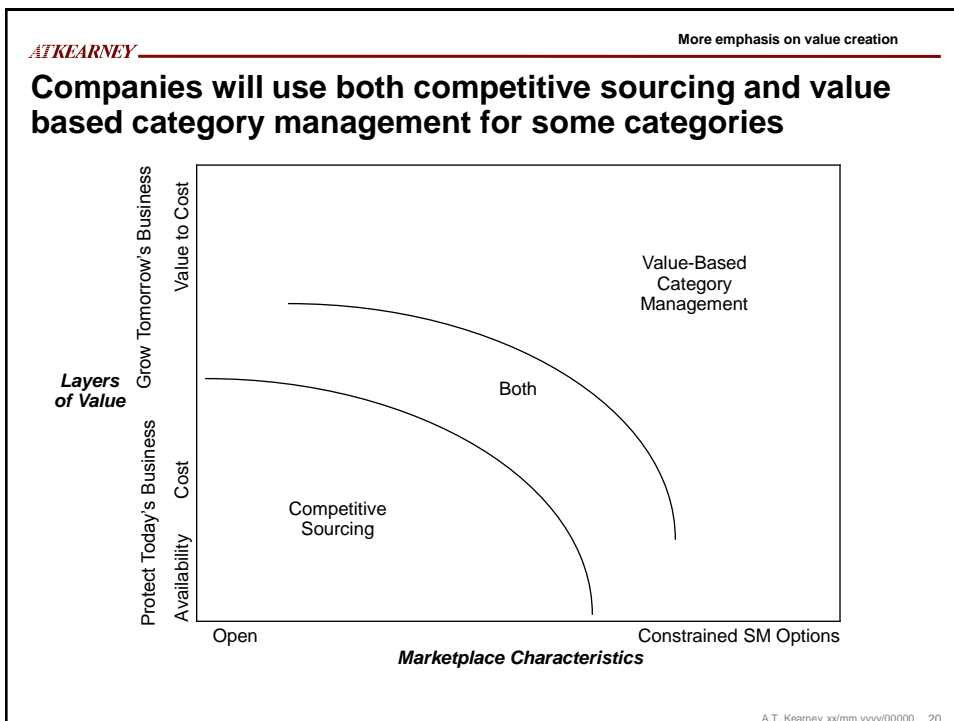
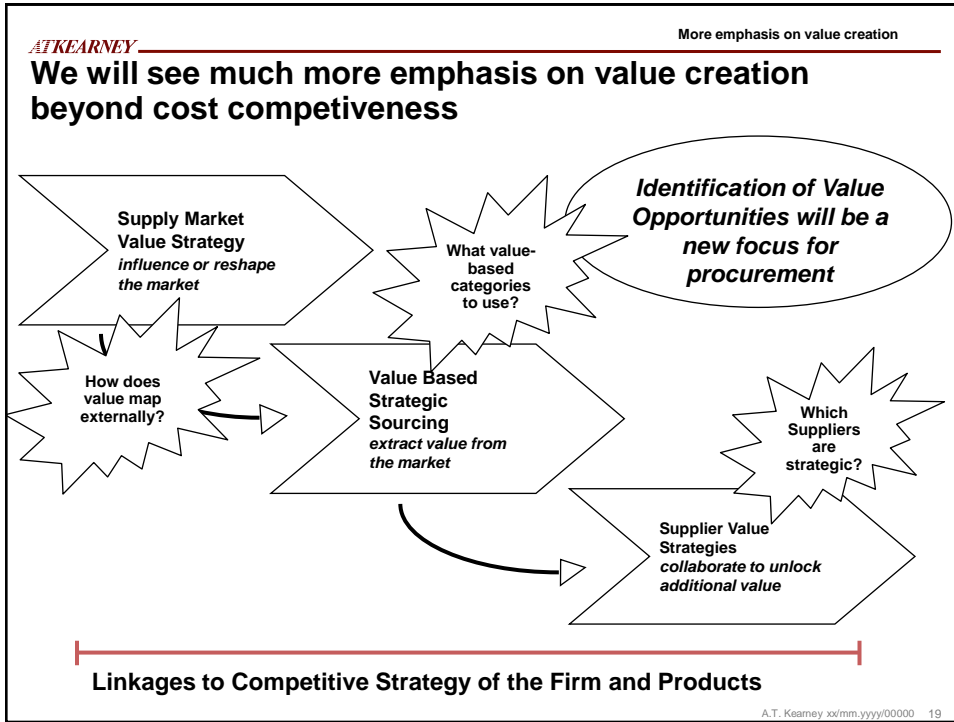
The current economic crisis is the worst since The Great Depression

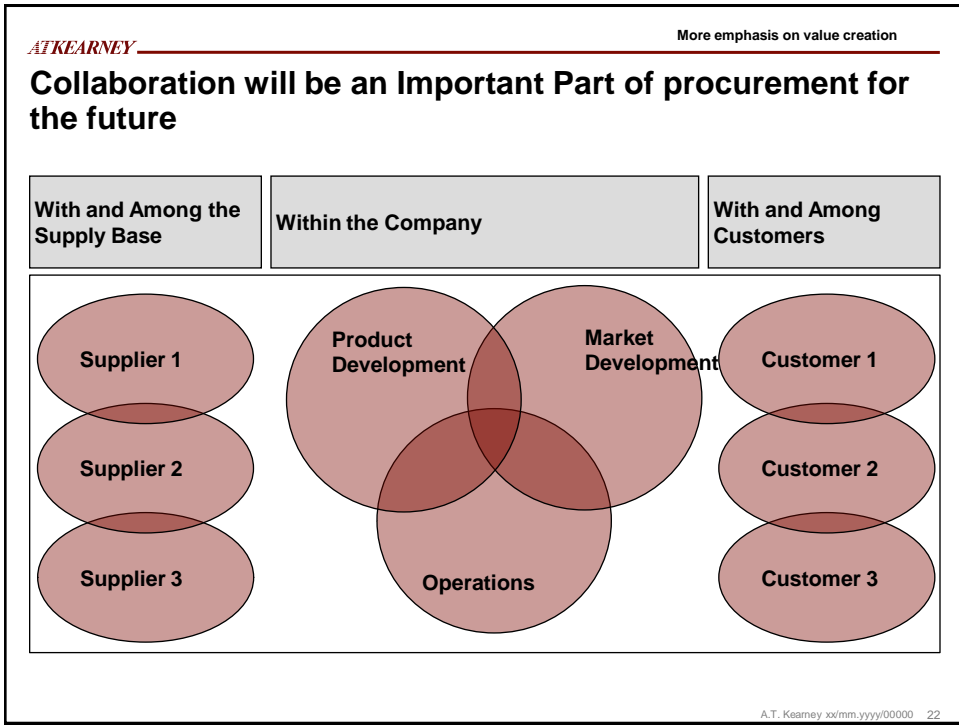
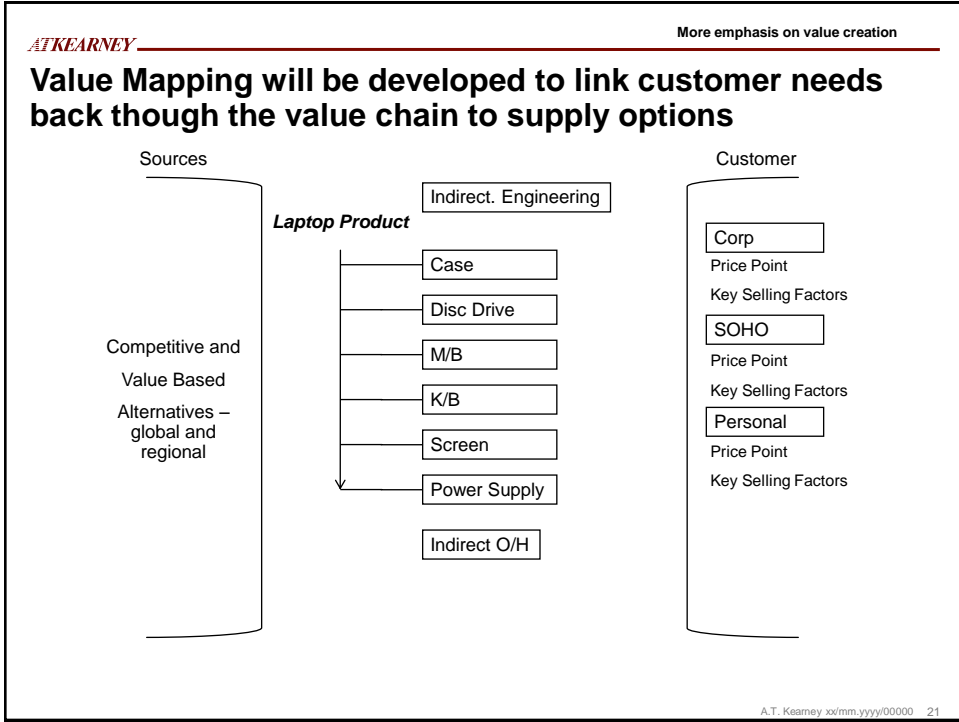
Despite this crisis, economic conditions are no where near as bad as during The Great Depression

Statistic	Great Depression	2008 Crash
Stock Market Decrease	• 89% Decrease (1929 to 1932)	• 45% Decrease (Oct 9, 2007 to Feb 13, 2009) then rebounded
Unemployment Rate	• 25% in 1933 (from 3% in 1929)	• 7.2% in Jan 2009 (prediction for 2010: ~10%)
GDP Decrease	• 27% Decrease (1929 to 1933)	• 1-3% Decrease for 2009 (prediction for 2010: recovery)
Banking System	• 1/3 of all banks failed (744 banks failed in first 10 months of 1930; 9,000 banks failed in the 1930s) • No bank deposit insurance	• Dozens of institutions failed • FDIC insurance (coverage limit increased to \$250,000)
Government Reaction	• Government allowed banks to fail • Lack of government deficit spending • Smoot-Hawley Tariff Act triggered a 50% collapse in world trade	• TARP/Government Stimulus • Integrated world trade (no protectionism backlash)

“There is no comparison — an order of magnitude difference in what we’re seeing — in the slowdown and the financial stress we’re seeing in this economy and what happened in the 1930s - so let’s put that out of our minds.” – Federal Reserve Chairman Ben Bernanke, a scholar of the Great Depression



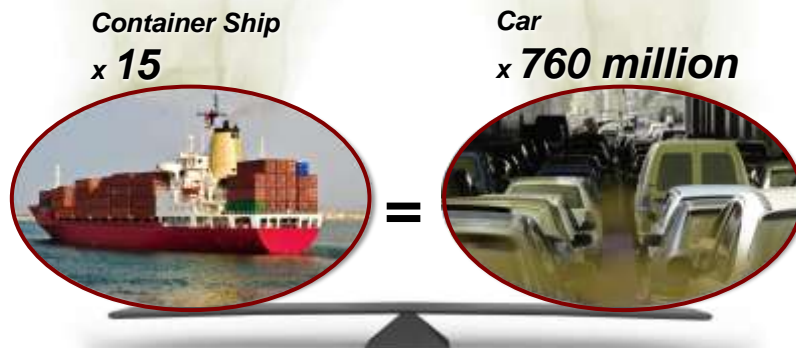




The Economic Downturn has show-cased increased concerns on the risks of globalization as we know it

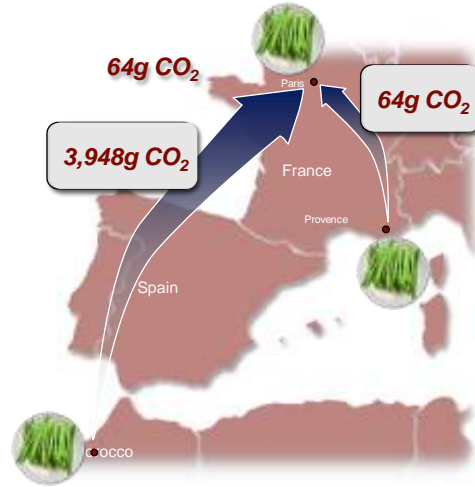
- Impact on sustainability
- Cost of Piracy and Terrorism
- Financial risk due to far-flung supply bases
- Financial risk due to interconnected government debt and bond purchases

The world's 15 largest container ships may be as toxic as all of the world's cars



Source: The Guardian; A.T. Kearney

Carbon costs can vary dramatically for the same product

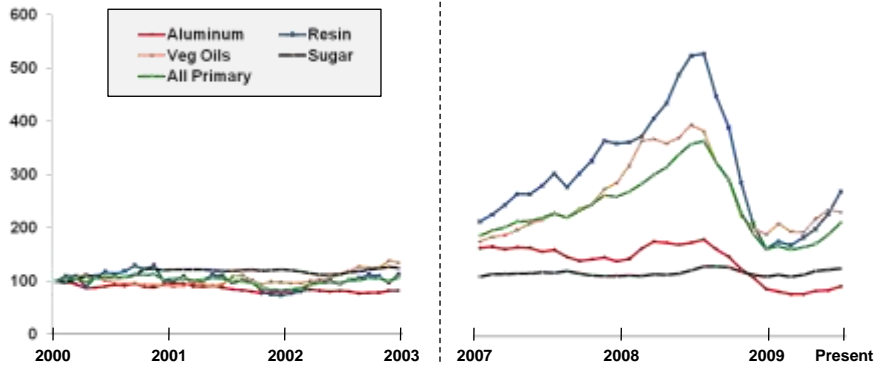


Source: A.T. Kearney

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The volatility of both soft and hard commodity prices has significantly increased over the last few years

Commodity Pricing Index, 2000-02 vs. 2007-Present (1)

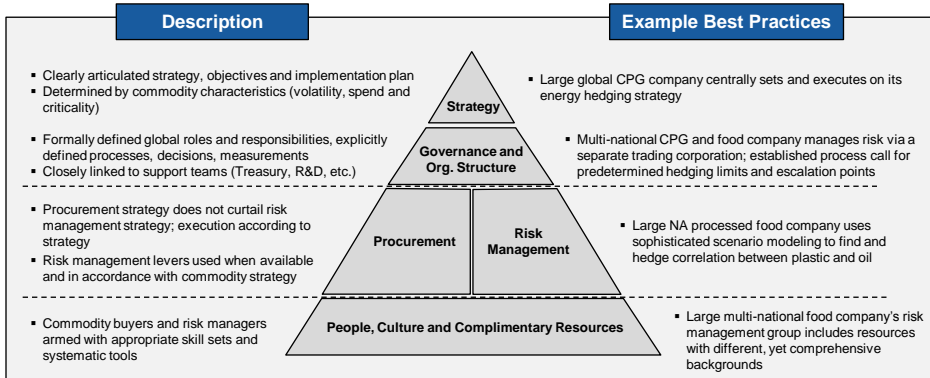


Notes: (1) Exchanges used per commodity: Aluminum – London Metals Exchange Standard Grade, Resin – UK Brent Light Blend Oil, Veg. Oils – Soybean Oil (Dutch), Sugar – US Import Contract 14; all prices normalized to base 100
The "All Primary" index (IMF) reflects over 50 commodities including energy, agro and industrial inputs
Source: International Monetary Fund

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Risk Management requires a systematic application of best practices adapted to individual company situations

A.T. Kearney "House of Risk Management"



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What skill sets will supply management professionals need?



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