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**IMPACT**

**Direct Material Value Transformation  
(DMVT)**

How to continually generate sustainable value in further maturing and competitive procurement environments

Many organizations have professionalized their direct material procurement in recent years, yet pressure on continually leveraging savings potential remains the top priority of today’s CPOs – but how can companies manage to achieve savings continually in a mature market? Deloitte’s DMVT delivers a well-established and proven approach.

**Status quo**

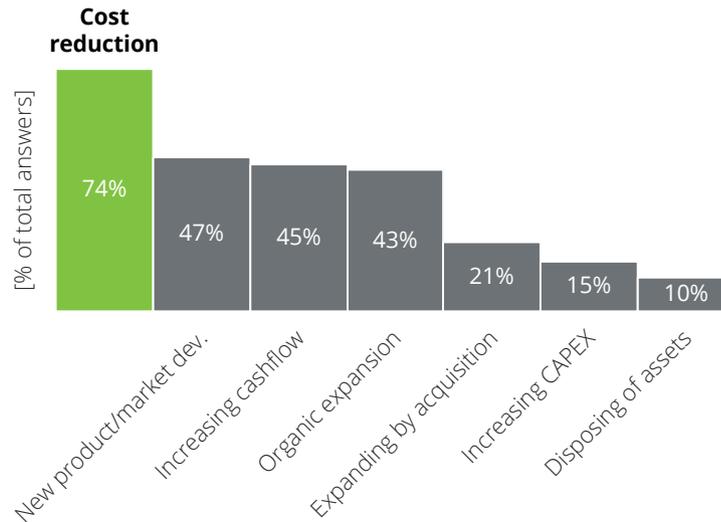
Strategic procurement has gone through a revolutionary transformation in recent decades, evolving from an irrelevant administrative department into a sophisticated and highly-valued function with significant influence on the company’s overall success. Over several years, tremendous efforts in most manufacturing industries have built global procurement organizations and implemented category management and corresponding lead buyer concepts. Also, best-cost country sourcing and global footprint optimization have become basic tools for any strategic buyer. All endeavors are focused on realizing annual savings targets to optimize material costs. In manufacturing industries in which material costs constitute up to 70 % of overall production costs, the strategic importance of procurement optimization is evident. While markets are maturing constantly, being accelerated even more by Industry 4.0 and by still intensifying

globalization, cost efficiency distinguishes successful companies from ones drowning in competition.

The trend towards cost reduction and cash flow optimization continues to be of the highest importance for today’s CPOs. In comparison to recent years, its significance has even increased. According to the current Deloitte CPO Survey, cost reduction is the top business priority for the future of 74 % of companies.

**Fig. 1 – Business strategy priorities 2015**

Source: Deloitte CPO Survey 2015



## Direct Material Value Transformation (DMVT)

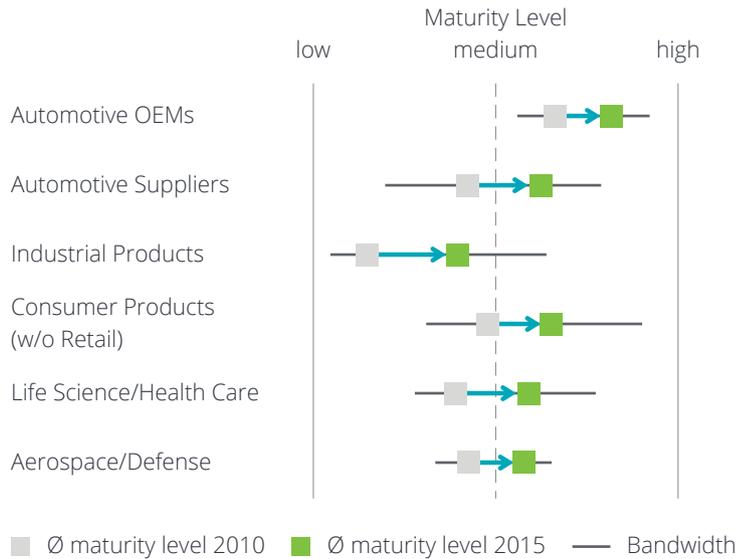
The very same companies have been investing in optimizing cost drivers along the supply chain for quite some time already. In the past five years, their average procurement maturity has increased significantly. Automotive OEMs in particular have taken the lead in developing their purchasing functions to best-in-class. They have leveraged maximum savings using a strong procurement strategy as well as an effectively performing and transparent organization.

Automotive OEMs as well as only a few leading companies in the diverse consumer products industry are forerunners in this procurement professionalization. At the same time other industries such as the majority of consumer products, automotive suppliers and industrial products manufacturers have started to catch up but have not yet fully completed their journey.

These heterogeneous development stages demand a differentiated optimization approach that is adaptable to the current maturity level of an organization. However, the more urgent need is to unveil innovative trends for future savings levers to secure sustainable cost reductions even when procurement has already matured.

**Fig. 2 – Development of Procurement Maturity Level 2010–2015 by Industry**

Source: Deloitte project experience



**DMVT basic principle**

Direct Material Value Transformation (DMVT) is a holistic approach to constantly developing an advanced procurement organization. Thus, it combines a balanced assortment of short-term actions to achieve immediate cost reductions and mid-term initiatives focused on sustainably developing the organization to accomplish optimal material costs, sustainable cost savings and at the same time increased product performance.

Over time, this approach delivers comparatively higher and more sustainable cost reductions.

The DMVT approach is based on four pillars for the constant improvement of a procurement organization.

The first pillar is Execution Quality, which ensures that basic procurement methodologies such as category management, supplier management and

negotiations are effectively performed to achieve optimal results.

To achieve this, the second pillar is substantial, being Training and Skills. While methods and tools can be optimized rapidly, it is also essential for procurement performance to develop the relevant capabilities of buyers for example by means of structured employee qualification programs.

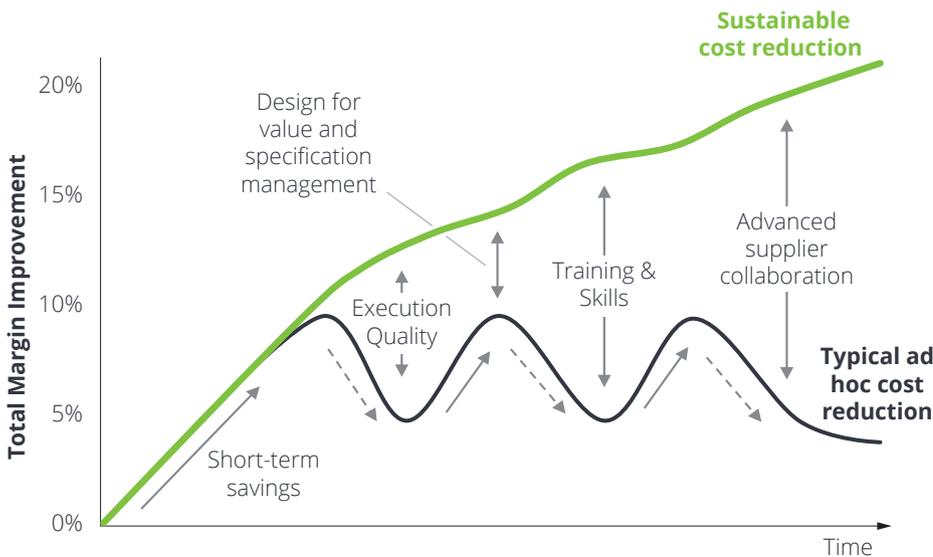
At the same time, the third pillar strives to reduce product complexity. By using Value Analysis and Value Engineering, the deep product know-how of interdisciplinary departments can be leveraged to identify customer value creation and eliminate unnecessary cost drivers. Using engineering knowledge, product costs can be avoided at early development stages and even during a product life cycle.

The fourth basic pillar of the DMVT approach is Advanced Supplier Collaboration. On the one hand it involves restructuring the supplier portfolio, on the other it allows the formation of strategic partnerships with innovative suppliers to enhance own value creation.

When developing an organization to best-in-class using DMVT, all four pillars are translated into precise levers and combined to achieve sustainable results.

**Fig. 3 – Cost reduction effect of successful Direct Material Value Transformation**

Source: Deloitte project experience



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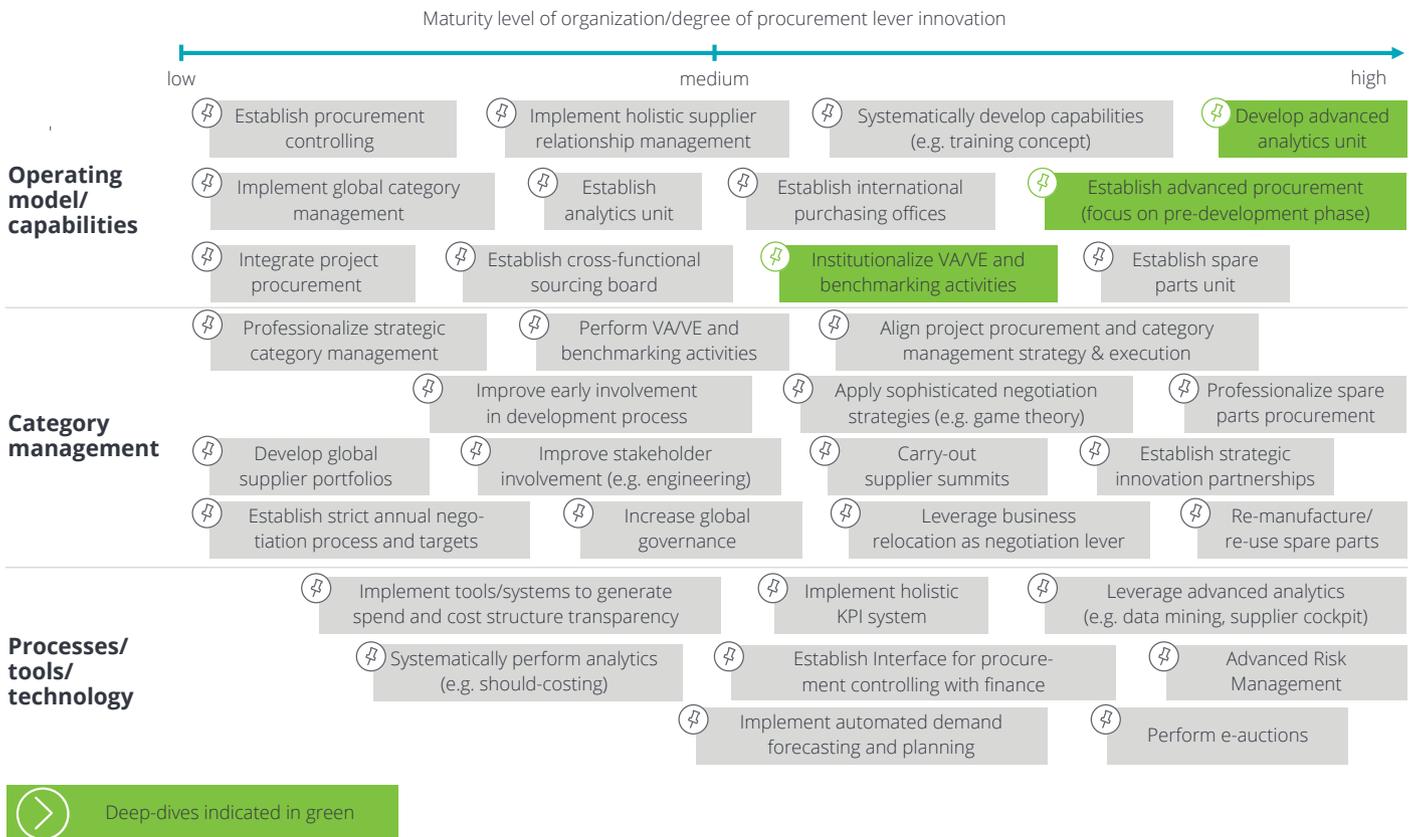
### Deloitte levers for cost reduction

The DMVT approach envisages a constant transformation of any procurement organization into one operating at its

finest and most effective. Depending on the current maturity level, the development stages and corresponding levers nonetheless need to be customized

and timed appropriately. This consecutive development makes long-lasting results and optimal procurement performance possible.

**Fig. 4 – Typical levers to drive direct material cost reductions**



Deloitte has developed a toolkit for achieving a best-in-class organization and validated its effectiveness with numerous successful procurement transformation projects on various continents, in diverse industries, and at different maturity levels.

More than 30 specific levers drive procurement maturity across the main components: operating model and capabilities, category management and processes, tools and technology. Their applicability is determined by the as-is maturity of the organization.

While basic levers range from establishing a professional category management to integrating project procurement and the establishment of strict annual negotiation targets and processes, more sophisticated ones include an advanced analytics unit, professional spare parts procurement, and making use of e-auctions.

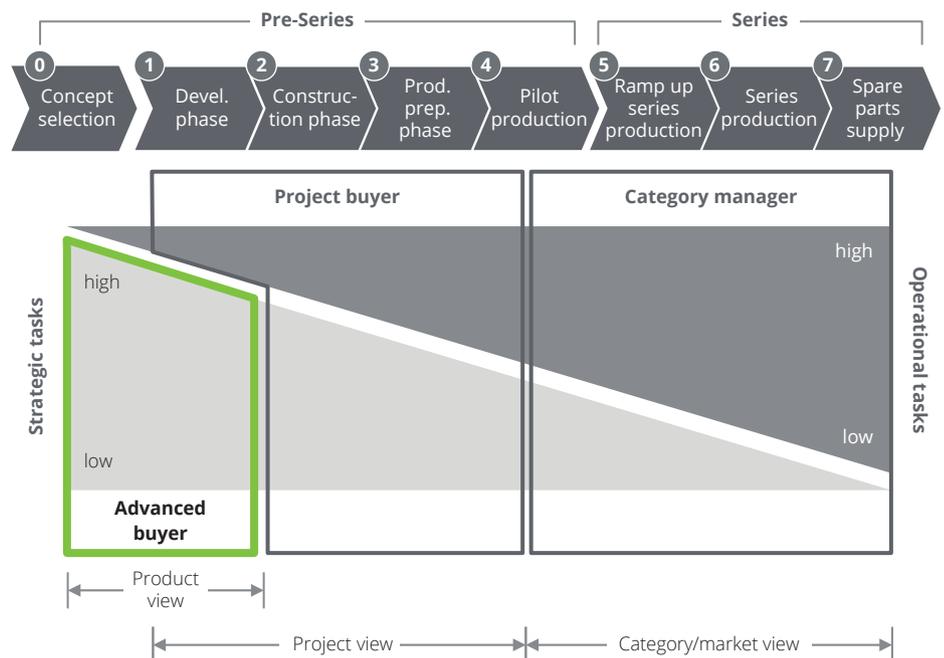
One lever for securing sustainable cost savings in rather mature procurement organizations is the establishment of an advanced procurement team focusing on the pre-development phase.

### Deep dive (1/3): Advanced procurement

Many companies have begun to involve the procurement department as project buyers in the development phase of a new product. However, this is no longer sufficient. Most product costs are already determined during the concept phase in which various technical requirements increase product complexity and consequently drive prices up at the same

time. When operating a highly mature procurement organization, companies need to tackle this complexity before it even arises in order to avoid material costs later. By involving procurement in the concept phase prior to development, an increased focus on cost is ensured. In our experience, overall product costs can be reduced by 10 to 15 % when this approach is strictly implemented.

Fig. 5 - Establish and integrate Advanced buyer in development process



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Unlike category managers, who assume responsibility for one category in series production, these advanced buyers are highly skilled and technically educated experts focusing on one product area. This allows them to develop a deep understanding of the product lines and to leverage know-how from one product to the other.

During the concept phase for a new product, they are part of the engineering team and their responsibility is to contribute information about supplier markets and purchasing costs. A critical success factor is also to enable their influence in design decisions by implementing approvals on agreed milestones and veto rights for cost-increasing decisions.

Because of the technical focus and pure project work, advanced procurement should form a separate unit in the procurement organization. This allows internal processes and structures to fulfill their role in the company's structure best.

### Deep dive (2/3): Design To Cost (DTC)

Once the idea of advanced procurement and early cost avoidance is embedded in the organization, finished products are defined with maximum cost efficiency at the beginning of the product lifecycle. Nevertheless, global supply markets are becoming increasingly dynamic. New challengers enter the marketplace every day, stimulating competition and thereby lowering prices. Furthermore, product innovations lead to more cost-efficient components and new technology enables more economic production procedures. This vibrant environment unlocks additional savings potential even during the product life cycle. Today's world challenges companies to constantly re-evaluate their material costs. For many years, Design To Cost (DTC) has been a well-established approach to analyzing components and their prices. Many organizations have successfully conducted one-time DTC initiatives and generated substantial savings. Nevertheless, many of them have not yet recognized this instrument as a systematic approach to periodically reviewing costs in order to generate savings during the whole life cycle. In a mature organization it serves as an institutionalized lever.

Deloitte recently completed a successful DTC project with one of our major clients in the industrial products industry. This billion-euro company with global reach

was struggling with high material costs because of limited modularization and high variety due to customer-related specifications. International competition with remarkable cost advantages lowered prices and put our client under pressure. Together, we implemented a sustainable DTC methodology embedded in a dedicated Value Engineering Office. Also, we conducted a one-time DTC initiative with a series of workshops to achieve immediate cost savings. As a team, procurement, engineering and production staff members defined various measures when comparing their own product tear-down to the ones of the competitors. From de-spec, de-contenting, to materials substitution, all improvements contributed to remarkable savings of more than 20 %. At the same time, a customer survey ensured the identification of market requirements and that customer value was maintained and indeed increased through DTC efforts.

In future, it will also be possible to host these DTC workshops in our Deloitte Tear Down Lab. It enables cross-functional teams to escape the daily routine and become even more creative. The Lab is specifically designed to enable product tear-downs for small as well as larger parts. With the latest technology such as 3D printers, design changes can be simulated quickly.

### Deep dive (3/3): Procurement analytics

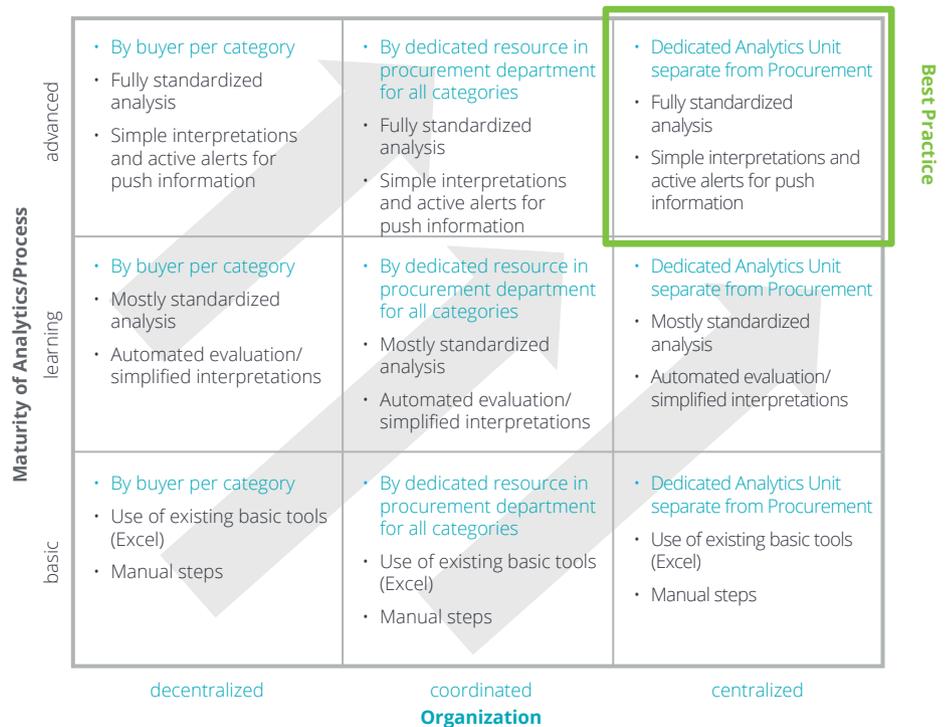
Digitalization and Big Data are buzzwords spreading through today’s media, promoted by thought leaders around the world. More and more information is being globally collected and mass-stored, while costs for storage capacity are lower than ever. At the same time, new database technologies enable significantly faster processing and new analysis tools offer user-friendly real-time evaluation.

In today’s world, where access to data has become a commodity, the key challenge for companies is rather to make use of the data available while using resources efficiently. A few years ago, numerous hours of nearly every procurement employee were spent on researching data from various sources, evaluating them manually and presenting them neatly.

Among other things, effective procurement requires diverse data about demand, costs, prices, and savings. Buzzwords are “spend cube”, linear pricing analysis, cost regression, “should-cost” analysis, and Total Cost of Ownership (TCO). Furthermore, figures such as Parts per million (Ppm), On Time/ In Full deliveries (OTIF) and Optimal Lot Size calculation are vital for supplier performance management. At the same time, Purchase to Pay Performance is frequently measured by volume and

quantity indicators such as stock and consumption level and cycle time. In summary, achieving data transparency was a struggle in the past in all major procurement activities.

Fig. 6 – Deep dive: Analytics Unit



## Direct Material Value Transformation (DMVT)

While nothing has changed with regard to the data requirements in procurement, the way in which companies collect data and conduct analysis has been reformed. Leading practice is a dedicated analytics unit centrally responsible for all standard requests. This group is usually embedded in the procurement organization, acting as a business service partner not only for strategic buyers. More frequently, companies are also outsourcing standard analysis with frequent use to external service partners. This unlocks substantial potential by transforming fix costs into variable ones, leveraging scale effects and ensuring constant improvement of IT tools and support. Leveraging our vast project experience and professional analytics capabilities, Deloitte provides analytics support on a managed service basis.

While a dedicated analytics unit enables category managers to focus on strategic tasks, many organizations have not yet implemented such an enabling service. Instead, most have a dedicated resource among the buyers to execute analysis. Others do not apply any consolidation. Each purchaser then spends time on data investigation only for their area of responsibility. Multiplied by the number of employees involved, the overall effort spent on analytics is much greater in such a decentralized scenario.

Apart from the organizational set-up, maturity levels vary significantly according to tools and processes used. While basics include Excel etc., more advanced solutions enable automated evaluation and simplified interpretations. Leading solutions additionally offer dynamic filtering and pro-active alert functions for push information. Usually both the maturity of the tools and the standardization of the scope of analysis increase proportionally. Based on tableau software, Deloitte has developed a Procurement analytics tool delivering best practice standards for frequently used analysis. Customizable structures allow the tailoring of all reports to our clients' needs while at the same time enabling a quick deployment.

### Schematic project approach and case study

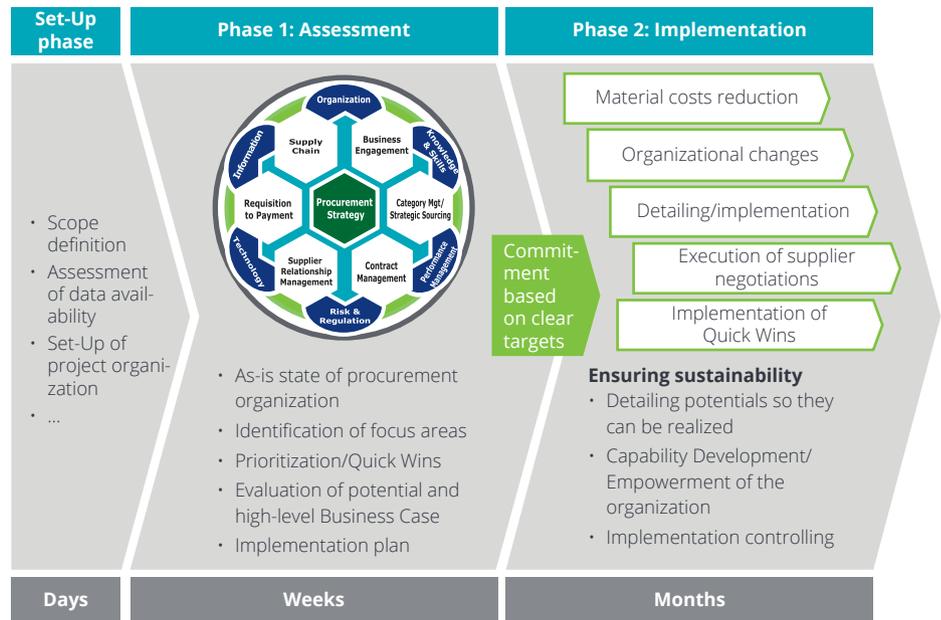
When approaching the value transformation journey with Deloitte, a two-step approach ensures an effective project and secures substantial cost savings. Usually, also a short set-up phase is required to align the project scope with our client and get stakeholders on board while we build the project organization.

#### Case Study: Value transformation for a billion-dollar automotive supplier (first tier)

Project set-up:

- Project target and scope: transform procurement function from a regional to a best practice global organization as well as identify and implement substantial and sustainable savings in all major direct and indirect categories
- Global project team covering major regions (Europe, Americas, Asia) and organized in 'tandem teams (client and Deloitte)'

Fig. 7 – Schematic project approach and case study



## Direct Material Value Transformation (DMVT)

In the first phase, an assessment delivers a clear picture of the present state of the client's organization. Our standard tools such as the Procurement 20:20 maturity model, enable fast deployment and assure benchmark quality. Depending on the agreed scope, our team conducts interviews and workshops with all relevant stakeholders. Our Global Sourcing Insights (GSI) tool as well as category insights with market and sourcing data for over 300 categories help us to challenge our client's current operating model thoroughly. With a clear as-is picture in mind, we elaborate areas for improvement, precise saving levers and discuss focus areas including prioritization and business cases. With the quick wins at hand, we define an implementation road map, to transform the procurement organization and generate savings both immediately and in future.

Depending on the levers identified and agreed upon during the assessment phase, we begin execution in phase 2. With our global experts we support our client in all steps along the way. Also, we leverage our tools such as the Deloitte Savings Benchmarking Database to detail potentials and savings targets. At the same time we empower our client's organization with a tailored training program and by supporting the implementation over several months.

### Assessment results:

- Key organizational development areas identified and organizational blueprint developed
- Capability assessment delivered clear as-is and to-be skill profiles as well as suggested change management actions to close identified gaps
- Savings potential of 8-12 % overall as well as implementation levers across all major direct and indirect categories identified
- Holistic 3-year implementation roadmap and detailed implementation plan for first 8 months developed and aligned with client leadership team

According to our client's needs and preferences, our team can also take a more active role in the process, for instance in executing RFPs and negotiations or delivering supply market analysis.

We have a maximum commitment to making our client's procurement organization successful, having a deep trust in the project results. We therefore offer value-based billing, coupling our consulting fees with the savings generated during the project.

### Key implementation results:

- Quick Wins of 5–10 % in several direct categories (e.g. castings, stampings) delivered
- New global operating model developed and organization and roles incl. new CPO established
- Tailored training curriculum developed and executed with key personnel (e.g. advanced negotiation skills)
- Category strategies and optimization plans for '1st wave' categories developed and first savings implemented
- Several design-to-cost workshops executed in cross-functional teams and savings levers identified, quantified and implementation initiated
- Savings of appr. 15 % identified for first 2 implementation waves (appr. 18 month implementation period) and 8 % realized within 1st wave (appr. 8 months)
- Amortization of project investment within the first year

### Our differentiators

Deloitte is a reliable partner for making our clients' procurement transformations successful by contributing five key success factors.

#### Global network of senior procurement experts

Our highly experienced procurement consultants have a proven track record of more than 1,000 successfully completed projects in 250+ categories delivering innovative solutions and complex procurement transformations globally.

#### Extensive industry know how

Our consultants have extensive experience in many industries, such as automotive, industrial and consumer products as well as life science. For example, over 12,000 Automotive experts are focused on delivering excellent project results across the entire supply chain from supplier to OEM to dealer.

#### Successful track record of Deloitte tools and insights

Diagnostic tools are consistently optimized with latest industry insights and successfully applied to our client projects. Contemporary benchmarks and insights into industry-specific best practice help to underpin project aims.

### Proven and pragmatic approach

Our experienced and highly focused consultants provide a sophisticated project structure in a cohesive roadmap accelerating benefit realization and enable follow-up on deliverables with a hands-on attitude

#### Maximum commitment to achieving goals together

Value-based billing motivates a constant focus on results, our drive to implementation ensures measurable and sustainable results (e.g. fee model with base fee + incentive fee)

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