



Procurement Value Optimization

How to secure future profits



Procurement value optimization – Why now?

Rising costs are putting future profits at risk, and now is the time for companies to act

After decades of price stability, inflation made a sudden comeback in 2022 and is now hitting companies harder than ever across all markets and industries. Not all businesses are in a position to pass on rising material costs through higher sales prices. Instead, they are increasing spend baselines and slashing margins, which puts future profitability at risk.

Consumer price inflation rose as high as 10% in Germany, and energy price hikes have been even more dramatic. In the year 2022, we saw energy costs skyrocket by 132%, while the price of intermediary products such as manufacturing materials increased by 17% during the same period. All of this has sent manufacturing costs soaring. As we saw with the start of 2023 already a declining inflation rate (~8.5%), we could think the prices will fall again. However projections for the future are showing that inflation has come to stay and energy prices will remain higher than they were before.

Given these drastic developments, companies are under pressure to take countermeasures aimed at bringing costs back under control and limiting growth in spend baselines. Net savings are often impossible to achieve in this new reality, challenging CPOs to look for ways to make procurement a source of value for their companies once more.

Ford hit by high supply costs - stock price down by 8 percent

– Handelsblatt, Sep 20, 2022

...9 out of 10 companies expect profits to fall...

– Bavarian Employers' Association for the Metalworking and Electrical Industries, Oct. 12, 2022

...despite growth in sales, Volvo's profits plummet 30%...

– WirtschaftsWoche, April 28, 2022

Rising energy and material costs put increasing pressure on BASF [...] EBIT plunged by nearly 28%...

– WirtschaftsWoche, Oct 12, 2022

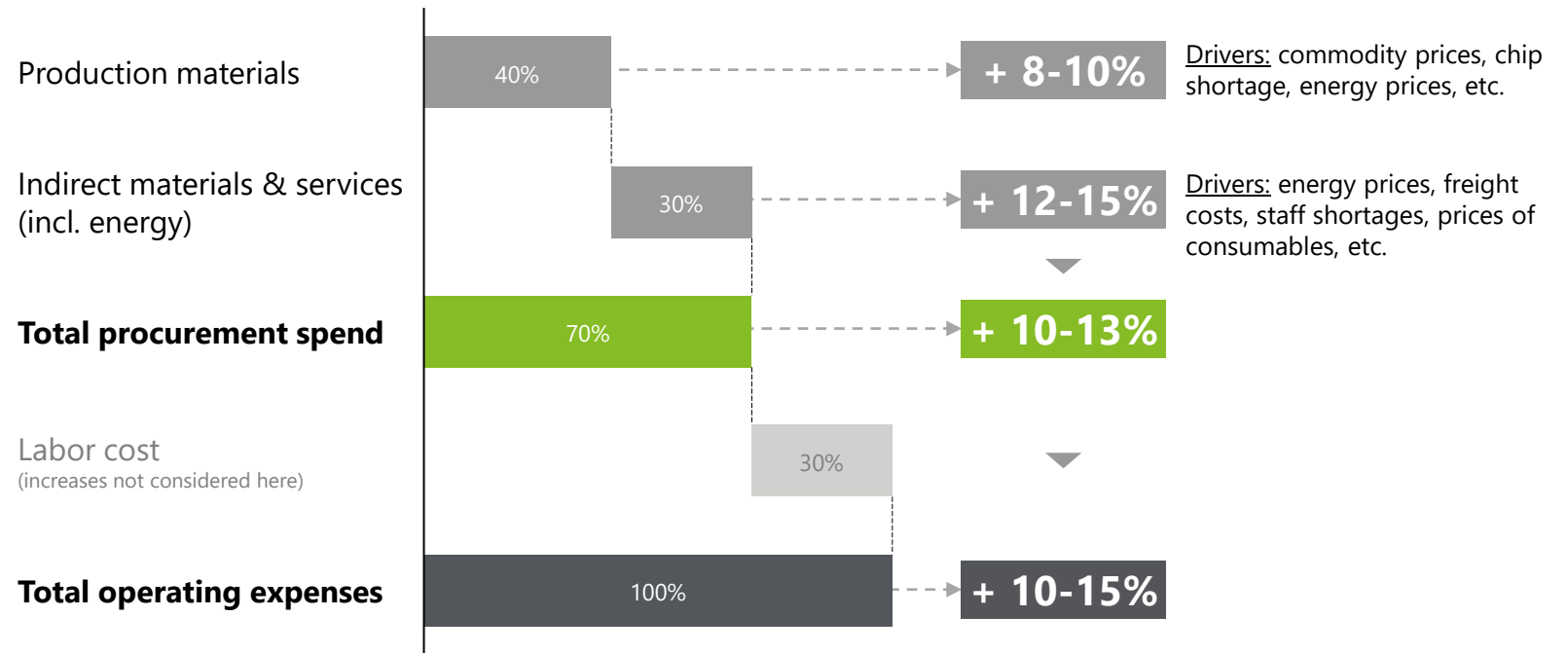
How rising supply costs impact the average manufacturer

Manufacturing companies typically face a 10 to 15 percent increase in their procurement spend

The recent price hikes have hit materials and services as well as direct and indirect costs. Based on our recent experience with clients from the German manufacturing industry, we typically see a **8-10%** increase in production material costs and a **12-15%** increase in indirect costs ranging from materials and services to energy.

The total impact on procurement costs is **10-13%** on average. And since these account for a large share of a manufacturer's operating expenses, the effects are serious. Typically, management is looking at a 10-15% increase in operating expenses, solely due to rising prices.

Needless to say, this has a devastating impact on operating income.



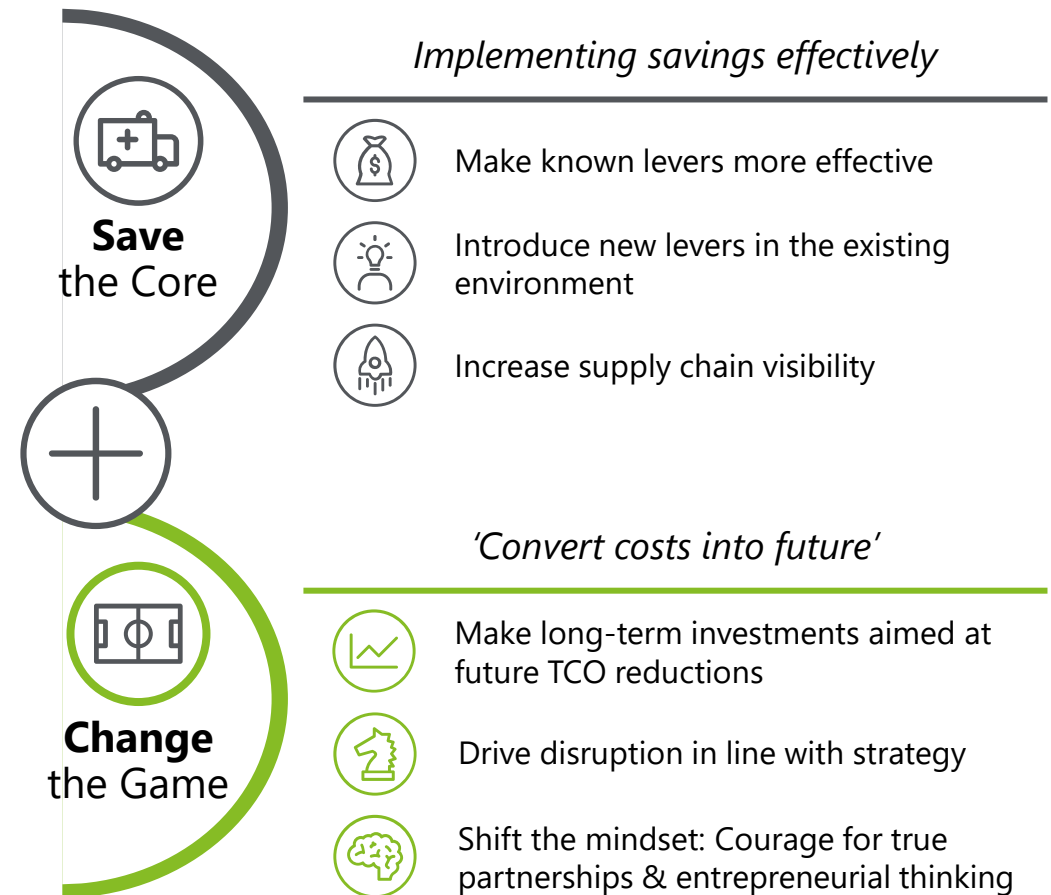
Changing the paradigm: “Save the Core” & “Change the Game”

To create real value during the current crisis, procurement managers need to (re-)think their strategy in two dimensions

Traditionally, procurement contributes value to your business through savings. Inflation is putting this core contribution at risk, forcing companies to step up their savings generation and cost avoidance efforts to compensate for rising prices. That means procurement managers need to make current cost-saving levers more effective and to introduce new ones to change the paradigm.

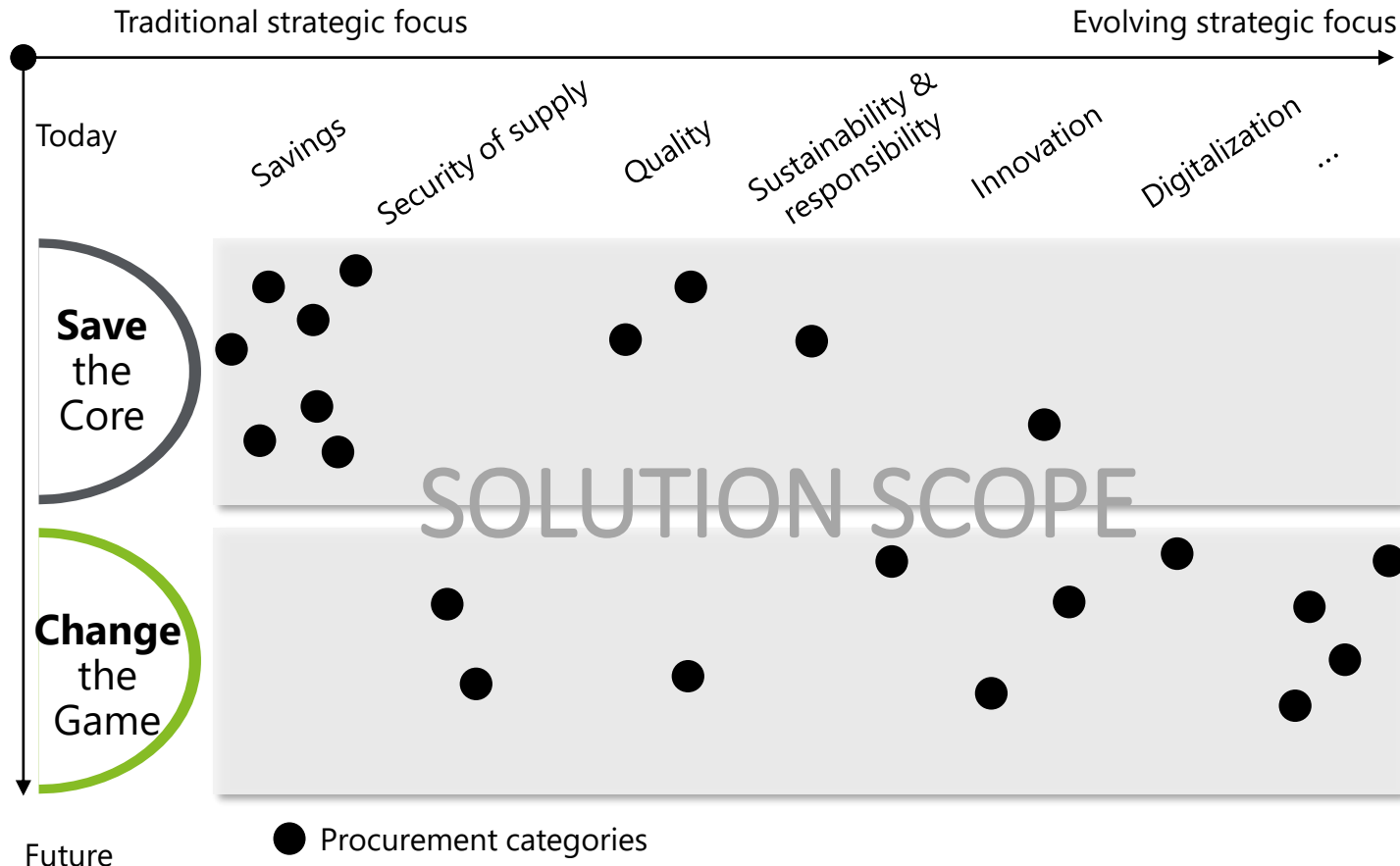
However, as long as inflation is raging and prices keep rising, even the most effective “Save the Core” initiatives may only slow the rate of cost increases without contributing significant net savings to your P&L. CPOs eager to generate value and secure future profits will need to look beyond short-term financial savings and completely change the procurement game.

“Changing the Game” means making investments in the short term that are not likely to pay off until a later date: from disruptive changes in procurement structures and processes to more collaborative supplier partnerships and a complete mindset shift. These changes will require some time and money at the outset and may not make a significant contribution to short-term cost reduction. Once they start to yield returns, however, they will play a huge role in procurement value creation – not only by avoiding or cutting future costs, but also by advancing the company’s broader strategic priorities.



Broadening the focus of category strategy development

By multi-dimensional category segmentation, procurement can find novel ways to orchestrate value



As outlined earlier, high inflation is forcing procurement departments to expand their value proposition beyond savings to new strategic priorities. These priorities will vary based on the overall strategy and may include areas such as sustainability, innovation or digitalization.

This requires a paradigm shift when it comes to developing category strategies. It is time to think beyond traditional aims such as savings or availability and broaden the focus to all relevant strategic priorities.

Your new category strategies will be more individual and more disruptive as a result. Broadening the strategic focus often also means rethinking supplier relationships and transforming them into “real” partnerships that promote innovation and safeguard future value. This elevates the role of procurement from savings generator to “value orchestrator” between the suppliers and the company.

Typical levers to “Save the Core” and “Change the Game” (examples)

In addition to rethinking portfolio management, a wide range of possible levers can drive procurement value



Mandate for Commitment

- Give sourcing staff a clearly defined mandate to make commitments to suppliers (within specified limits)
- **Benefit:** This allows buyers to make long-term volume commitments and employ more effective negotiation tactics, making suppliers more willing to concede to short-term savings.

Cash for savings

- “Prefinancing” through adjusted payment terms, cost-sharing in R&D or tooling, etc.
- **Benefit:** Suppliers may be willing to offer a price reduction in return, enabling buyers to secure long-term savings in exchange for cash upfront.

Additional levers

A wide variety of levers are feasible, depending on the individual company, for example:

- *Expand the supplier base*
- *Manage demand & specifications*
- *Optimize pricing structure*
- ...



Leverage automation & AI

- Introduce innovative tools, e.g., 24/7 AI-assisted market screening or automated low-value sourcing using natural language processing bots
- **Benefit:** Procurement can focus its efforts on value-add activities such as optimizing category and sourcing strategies, negotiating and supplier relationship management.

Link future business

- Link supplier pricing to future award decisions and align across commodities, e.g., a supplier’s price hikes will lead to a penalty in future tenders.
- **Benefit:** This incentivizes suppliers to refrain from extreme price increases, helping you achieve more price stability over the long term.

Additional levers

- *Long-term innovation partnerships with key suppliers to foster collaboration between suppliers and your R&D department*
- *Structural improvements within the procurement department (e.g., organization, incentives, staffing, ...)*
- ...

 “Changing the Game” requires profound organizational and structural changes as well as a new way of communicating!

“Change the Game” also means “Change the Tone”

Changing the game requires procurement organizations to rethink their communication strategy – shifting from typically restrictive and defensive messaging to an authentic partnership narrative

Internal communications & mindset

Companies need to establish a new mindset and a new self-image within their procurement organization – from buyers all the way to the CPO. This typically requires dedicated change, enablement and communication initiatives.

Communication with partners

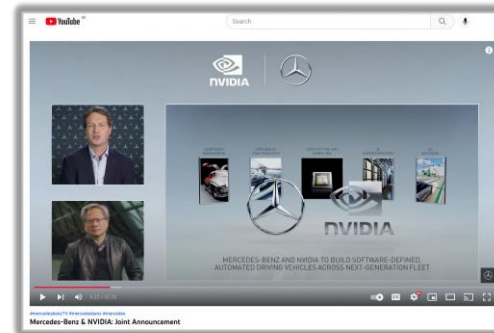
Companies need to show core suppliers that they are committed to the partnership for the long term and with the necessary support. One way to do this is through “signature moves”, such as investing in sustainability solutions with a dedicated messaging campaign.

Communication with the broader public

Working with suppliers on joint communication campaigns can take partnership and co-creation “to a new level” (see Mercedes-Benz case study).

Case study: Mercedes-Benz

Mercedes-Benz and NVIDIA used a joint video statement by their CEOs to publicly announce their partnership for software-defined vehicles, which received a great deal of media attention. The two companies have also repeatedly expressed their mutual appreciation and showcased their partnership in press releases and social media posts.



“Mercedes will become the most valuable luxury brand on the planet”

– Jensen Huang, CEO NVIDIA

“NVIDIA And Mercedes-Benz Join Forces In An Autonomous Car Power Play”

– Forbes

- A deeper level of trust and a committed partnership creates the ideal environment for mutually beneficial long-term co-innovation projects.
- Mercedes-Benz’ brand perception as a technology leader only gets stronger with more public attention towards their tech partnership.

How to kick off your procurement value optimization journey?

At Deloitte, we have the experience, methods and assets you need to “Save the Core” and “Change the Game”

What you need to do

Our approach in a nutshell

- ✓ Re-think your **supplier portfolio**
- ✓ Walk in your **supplier’s** shoes: What drives them?
- ✓ Invest in **real, long-term** partnerships
- ✓ Use existing levers **more effectively** and introduce **new ones**
- ✓ **Change the tone:** create enthusiasm internally and externally

What we can do to help

Our success factors

-  **Procurement expertise**
-  **Experienced** project team
-  State-of-the-art **analytics**
-  **Cross-functional** capabilities
-  Expertise in **supply chain resilience**

Contacts

We would love to hear from you!

Get in contact with us to discuss how Deloitte can support you in securing your future profits and optimizing your procurement value.



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