

Chapter 1

“When It Comes to Purchasing, We All Consider Ourselves World Champions”

If you believe McKinsey, one of the top names in international strategy and management consulting, Germany has long learned the “Always low prices” lesson. In a recent study, consultants rated price awareness among German consumers as the highest in Europe. Despite being at the top of most personal agenda lists, price awareness has yet to become the standard among companies. A fatal error leads to an enormous waste of capital: minor league purchasers consider themselves to be at the world champion level. If the entire purchasing volume were at around one billion euro and the potential values were gradually invested, you can imagine the potential thousands of millions that have not been exploited just within German enterprises in the past.

Those warming up for the Champions’ League can hardly expect a sympathy bonus. You might remember the uproar in the media, when in 1987 Dr. José Ignacio López de Arriortúa from Spain went on his first shopping tour as the chief purchaser for General Motors Europe. Excitement and pure desperation caused massively shaken suppliers to break out in cold sweat. It took only a couple of weeks for the industry to fear the man from the Basque province almost as much as the devil fears holy water. Never before did a purchaser want to have a look at their production facilities and the efficiency of their production processes. Sources of turnover and profits that had been secure for decades were now in danger of running dry. Suppliers were said to be threatened by widespread extinction.

Purchasing – the Sleeping Beauty? – A Spaniard Reawakens a Whole Industry

The reality turned out very differently in most cases: López introduced the global market to the purchasing process called “global sourcing.” The current suppliers were quantified by means of the resulting benchmarks, which the suppliers in turn often saw as unrealistic. Nonetheless, the Spaniard managed to convert the existing supplier base by conducting “Continuous Improvement Workshops.” The visit of the López team turned into a productivity spiral at Siemens and elsewhere. While inspecting an assembly line of air conditioners for the global electronics player, the Opel (German GM brand) management crew discovered unused productivity potential of a legendary 46 percent and also delivered the instructions for erasing the existing deficits. To top it off, López and his team reduced average assembly line time by 85 percent and inventories by 95 percent. As a result, the production costs for Siemens were lowered by an overwhelming 20 percent. Of course, the Spaniard wasn’t out to be the supplier’s Robin Hood, but rather expected the Opel supplier to make price breaks in return for his profitability improvement tips. Today, many suppliers who were outspoken opponents of the unconventional methods during the López era readily admit that without his guidance, they probably would never have even started the urgently needed restructuring, not to mention finishing it successfully.

When López signed on with Volkswagen in 1993, he extended the “global sourcing” process into the so-called “forward sourcing” process, which became considerably more important for the overall purchasing process afterwards. The “forward sourcing” process includes the search for partners who already have introduced a new quality into the supplier partnership by offering life-time contracts and creating cost transparency on the basis of target specifications. The continual integration of the procurement market in the development process saved billions in the development of new automotive generations. Almost all other German automotive manufacturers have since followed this example.

If the former Opel/Volkswagen purchaser was not still widely viewed with such suspicion, he would surely be the unofficial world

champion of purchasers today. Nobody could convincingly clarify whether the Basque had really taken confidential documents with him when joining the Volkswagen board or not. López's self presentation as a kind of cult sheds an odd light on "Inaki," as his fans still call him. His blamable departure from Volkswagen created an unpleasant echo for him in the press: he was presented as one of the main reasons for the enormous quality crisis in the Wolfsburg-based company. Personally, I am not surprised by this false assessment. All the suppliers who undoubtedly profited from the improvement due to Inaki's efforts showed no signs of confirming his merits, but the losers (and there are always bound to be some) later voiced their opinion loudly. In my opinion, López is still the first top manager who recognized the great importance of purchasing and acted accordingly.

Enormous Profit Potential Is Wasting Away in Purchasing Departments

I stand by no means alone with this assessment. For instance, Dr. Thomas Ludwig, former CEO of ThyssenKrupp Serv AG (process and supply services like production support, scaffold services, and facility management, as well as warehouse and logistic solutions), wonders why "after the automotive industry, no other industry followed suit and initiated a similar process." Ludwig knows from his own experience as a former chief purchaser what enormous profit potential consistent procurement management can generate. He thinks therefore, that it is quite natural to "continuously put purchasing to the test and keep looking for existing shortcomings." According to Ludwig, these regular checks have to be a CEO's task or at least be supervised by a member of the top-level management. The chairman is not convinced of a sufficient skill among purchasing managers: "Many of them are not nearly as qualified as the leadership teams in other divisions." This is an unforgivable deficit because, Ludwig says, "You can't make money anywhere else as fast as in purchasing. Purchasing departments, especially in manufacturing businesses, have to be run by grade A people." The fact that he may arouse rage among purchasing managers by criticizing their

capabilities doesn't bother him at all: "I am simply criticizing facts, because I keep finding them over and over."

However, there are few other enterprises in which purchasing enjoys such a high standing as at ThyssenKrupp Serv. More often than not, corporate management considers procurement the "ugly stepchild" of the divisions, and it is therefore neglected. This makes purchasing a mass graveyard for billions within the economy. With our consulting projects, which are carried out in companies of all sizes and from almost all industries, we reduce procurement expenditures by an average of 13 percent. These measures alone result in profit increases of millions of euro.

Depending on the Industry, the Focus Varies between Research & Development, Sales and Marketing

Why is there a lack of interest in purchasing on the part of managers who are normally fixated on maximizing turnover and profit? The very simple explanation, which will certainly not be heartily welcomed by those concerned, is that most CEOs and general managers concentrate on research and development, financing, controlling, and sales and marketing, depending on the industry, instead of making use of the thrust that an improved procurement management might add to corporate profits. Moreover, most of them have not gathered any experience whatsoever in purchasing. I may be in danger of sounding cynical, but in many companies purchasing serves as a reservoir for more or less merited employees who nobody is prepared to get rid of or pay severance money to. This makes purchasing correspondingly unattractive for young talent. I believe this attitude makes sense. Would you like to begin your professional career in an area where the corporate car is widely unknown and the corporate mobile phone is considered an exaggerated item of luxury? Would you like to work in a department is seen by other departments as ranking slightly higher than the "lowly" post office? Last but not least, as a purchaser you must frequently cope with the fact that you are the laughing stock of friends and acquaintances, being awarded titles such as "pencil buyer with a diploma" or "simple-minded pinch-

penny.” Now and again – unfortunately for purchasers – there is actually some truth in the job description of “pencil buyer with a diploma.” In many cases, the functional departments handle complex orders themselves, without even involving the purchasing department. This degrades the purchaser to being a gatekeeper of a railway line that has long since been out of operation.

Purchasing Must Become a CEO’s Responsibility

Even banks and savings institutes, which require their clientele to deliver top operational performances, allow themselves such a gatekeeper or refrain from installing a central purchasing department. Local branches buy office furniture and supplies on their own, leading to exaggerated prices. Modern procurement techniques are almost unknown to the banking world. A survey carried out by the German Federal Association of Materials Management, Purchasing, and Logistics (BME), found how little the corporate management of large institutions is concerned with efficient procurement. 15 percent of the participating financial institutions did not have a remote idea of the number of suppliers their institution uses. They only vaguely knew the annual procurement volume. In almost half the institutions, the responsibility for procurement is placed on the third level of the hierarchy system, the middle management. No thought is given to the possibility of making the topic a matter for the executive team, as Dr. Ludwig of ThyssenKrupp Serv demands.

Employee qualifications are pretty pathetic: only about 20 percent of the purchasers of large banks and savings institutes are university graduates. At medium-sized and small businesses, the percentage is even worse: only a meager 2.6 percent attended a polytechnic college; 8.5 percent attended a university. This terrifying result puts the economic competency and foresight of many institutes in a dubious light. The BME’s critique is accordingly negative, even if the experts wrap the desolate situation in moderate terms by saying, “the basic qualification level can be assessed as ‘insufficient.’” In the organizational area, the association identified “partially elementary defi-

ciencies, mainly in the institutional and personnel-related assignment of purchasing and procurement responsibilities.” The BME concluded, “The purchasing functions are frequently underestimated in their value. Their possibilities sometimes even remain completely disregarded. Moreover, hardly any institution utilizes the purchasing function in order to improve its revenue.” Instead of massively cutting jobs and straining already heavily burdened budgets, the financial institutions could have been exploiting considerable potential by restructuring their procurement.

A position in purchasing is usually poorly paid and, adding insult to injury, commands no respect. The compensation consulting firm Watson Wyatt found that purchasers received an average salary of 40,000 euro in 2001, whereas sales employees earned about 74,000 euro. A corporate car was granted to only one percent of the procurement staff as compared to about 75 percent of the sales staff. No wonder that sooner or later the purchasing staff is seized by frustration. Salespersons, among whom I counted myself long ago, mercilessly exploit frustrated purchasers in order to obtain their desired prices. A few compliments are often enough to get the unmotivated purchaser to place a lucrative order. My former professional colleagues do not only have a psychological talent, but the majority of them are brilliant actors as well. If there was an Oscar to be awarded for “complaining on the highest level,” I could nominate several of them, and each would be very deserving of the prize. During our consulting projects, we repeatedly experience the same phenomenon: traditional purchasers unfortunately respond to this first-class act by placing the desired order without so much as having negotiated prices and terms of delivery in detail.

A Plea on Behalf of Our Purchasers

Many purchasing managers and their teams will probably judge my harsh criticism as a consultant run amok who wants to draw attention to his services by over-exaggerating the situation. I understand this reaction, but I am by no means interested in the defamation of an entire profession. Quite on the contrary, my colleagues and I have worked to give purchasing and its staff their due respect. Therefore,

in this book, you will read nothing about the tedious topic of bribery, that purchasers have to resist time after time.

I intend to show the ideal purchasing department and the enormous additional sources of revenue that can be exploited with a motivated and highly qualified procurement team. First of all, management has to take a fresh view of the function and the potential of the department. However, this will not work without well-presented, easy-to-grasp examples taken from entrepreneurial everyday life. These examples clearly present the existing weaknesses and their effects on employees. This means that the purchasers presented in the examples respond to their environment and exploit what little room to maneuver they are granted. They are by no means unwilling or unqualified by nature.

The freedom granted to many purchasers is very tight: purchasing department employees spend approximately 80 percent of their working time on administrative tasks. I would not react to such a monotonous workday with above-average commitment either. Fortunately more and more companies are restructuring their procurement divisions. One of these companies, for instance, is the German telecommunications provider debitel AG. “Before we streamlined our company, the purchasers had to spend about 70 percent of their time on administrative tasks and could, therefore, only become strategically-operationally active during about 30 percent of their time,” sums up Dr. Jörg E. Wilhelm, former head of purchasing and logistics at the Stuttgart-based company. He then describes the current situation: “Now the ratio is completely the opposite, with the result that the purchasers – after having gone through the proper ‘on-the-job training’ during the reorganization – can now concentrate on operational and strategic procurement. The administrative work, as far as it can be standardized, is mostly left to the EDP systems, naturally making full use of e-procurement. Consequently, the procurement staff can now grapple with the product, the supplier, and the procurement market.”

Reiner Meindl’s purchasers enjoy similar motivational support. The CEO of the German-based Heinz Holding GmbH & Co. KG, one of the world’s oldest leading manufacturers of high-quality glass and plastic packaging, gave his purchasers a distinctly higher standing than they had had in the past. “Previously, many different offices did

purchasing without involving the purchasing department,” reports Meindl. New structures now specify that considerably more is to be ordered via the purchasing department, which has boosted the self-esteem among the company’s purchasers. It was no question for the Heinz procurement team that they would support the management’s restructuring with all their might. Meindl adds with self-criticism: “We were astonished to find how insufficiently our procurement had been organized.” Purchasers in other companies can only dream of this understanding. They often have no other alternative but to make the best of a bad situation. It is no wonder that people who are so frustrated tend to show the sort of reactions presented in the following cases.

Now the time has come to put purchasing to the test, break up old structures, and run modern, efficient procurement management together with a motivated team. Purchasers who are finally given attractive professional perspectives and challenging tasks create the basis for a highly profit-focused purchasing function within the enterprise. The success of such restructuring measures will be seen after only a few weeks, much faster than with traditional procedures, such as job reduction.

My request to take the initiative is not directed only at large enterprises. Medium-sized companies must address the red-hot topic of procurement, especially in times when banks are raising the bar for credit-worthiness due to Basel II and profit increases by raising prices are practically impossible to achieve. There are many ways of optimizing procurement, even when entrepreneurs feel that everything is running smoothly in their purchasing departments. Furthermore, long-standing personal relationships between supplier and entrepreneur are no guarantee for excellent terms and conditions: the truth is quite the opposite.

The path to success is called “strategic procurement management.” In the following pages, I will demonstrate how this efficient kind of buying can work in your company as well. And not just with theory, but through a multitude of convincing examples. So I would like to invite you to “discover the dormant revenue potential so that your purchasing does not turn into the Bermuda Triangle for millions of euro.” Your employees will thank you for your commitment and contribute to achieving the goals as rapidly as possible. Both com-

pany and employee will benefit from strategic procurement management, making this book not only a guide for management, but also for all purchasers who do not want to be suffocated by the daily grind, but rather set the course of the company with their work.

