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The talent factor in **purchasing**

Nicolas Reinecke, Peter Spiller, and Drew Ungerman

Serge Bloch

Better purchasing can be beneficial in surprising ways, some far removed from purchasing itself.

Executives know that talent matters in procurement. But how much does it matter? A McKinsey global survey of purchasing executives at more than 200 companies finds that those setting the pace in purchasing best practices differ from ordinary companies along three talent dimensions. Together, these dimensions are associated with nearly 60 percent of the difference between the financial performance[1] of these two classes of companies. The top-performing ones hire better people in sourcing, set clearer performance aspirations for them, and create strong sourcing cultures that encourage purchasers to align their activities with corporate strategy. The payoff? Leading companies enjoy annual cost savings from their overall sourcing efforts that are nearly six times greater than the annual savings of low performers. Moreover, the winners are positioning themselves for broader strategic gains as the pressures of globalization intensify.

The survey,[2] conducted together with the Supply Management Institute of the European Business School, assessed the performance of the respondents' companies against recognized best practices in purchasing and supply management by analyzing responses along four dimensions: the capabilities and cultures of purchasing professionals and their organizations, respectively; the corporate structure and systems that support purchasing; the management techniques and business processes supporting it; and the contribution of purchasers to their companies and the extent of the alignment between purchasing and corporate strategy. Two interviewers independently assessed the executives' responses using a scale of one to five (five being the highest score). Subsequent regression and cluster analysis of the scores isolated 35 low-, 106 moderate-, and 61 high-performing organizations distributed across all of the industries and geographies studied.[3]

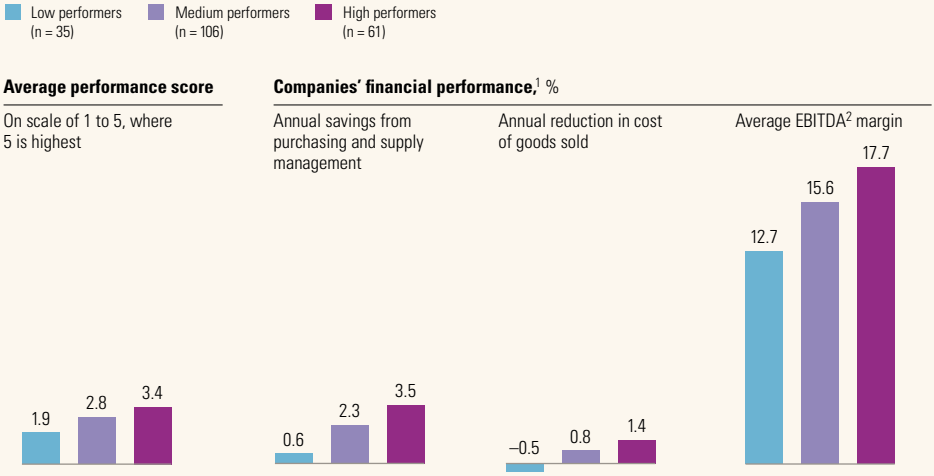
When we compared the scores of these executives with the financial results of their companies' purchasing efforts, we found a striking correlation (Exhibit 1). Top companies realized purchasing savings of more than 3 percent a year—two percentage points higher than the annual savings of the low performers.[4] High performers also had EBITDA[5] margins that were fully five percentage points higher than those of low performers.

A closer look at the relationship between a company's purchasing score and its overall financial performance revealed that three talent dimensions accounted for a disproportionate share of the top

EXHIBIT 1

The payoff

Performance against recognized best practices in purchasing and supply management



[1] Averages over 3 most recent fiscal years; for companies operating in Africa, Asia, Europe, and North and South America in the following industries: automotive and assembly, chemicals, consumer packaged goods, energy and utilities, financial services, high tech and telecommunications, materials and construction, pharmaceuticals, retailing, travel and logistics, transportation.
[2] Earnings before interest, taxes, depreciation, and amortization.

Source: 2006 McKinsey–Supply Management Institute (European Business School) survey of purchasing executives at >200 companies

performers' benefits. Together, these factors explain 57 percent of the financial improvement associated with a one-point hike in the purchasing score (Exhibit 2).

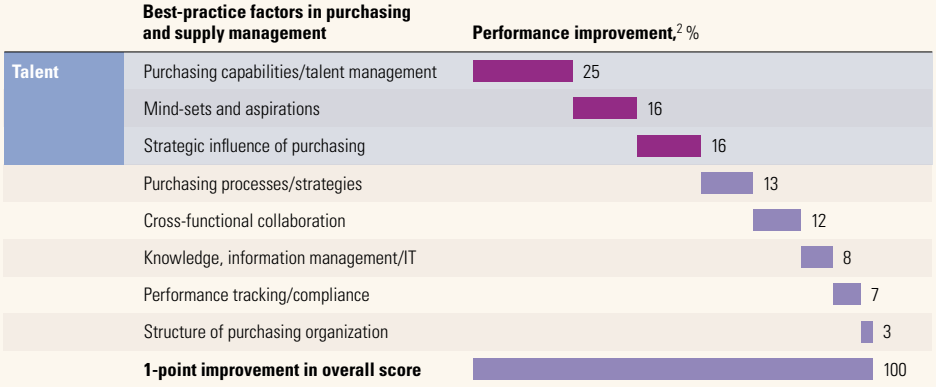
The first talent dimension involved the capabilities of the purchasing units themselves. High performers, for example, were five times more likely than low ones to employ purchasing managers with analytical expertise and general-management backgrounds, in addition to deep knowledge of a particular purchasing category (such as packaging). Likewise, purchasing managers at the top companies were six times more likely to have worked in another functional area (such as product development or engineering) than were managers at low-performing companies. Top companies also set clear career paths for purchasers. Seventy-six percent of high-performing companies tailor the training that purchasers receive—for instance, through functional rotations ensuring that purchasers get broad business experience. Only 11 percent of the low performers do so, and in our experience such organizational insularity prevents purchasing executives from contributing to the product- and service-development discussions, with suppliers and other stakeholders, that often lead to bigger savings.

We found that the second talent dimension involved the way purchasers view their roles and the aspirations they associate with those roles. Among top performers, 69 percent of the purchasing executives felt that their CEOs expected more from them than the ability to cut costs (and 81 percent of these purchasers articulated a clear vision for achieving other goals). By contrast, 49 percent of the purchasers

EXHIBIT 2

People matter most

Weight of factors associated with 1-point increase in survey score[1]



[1] Survey score (on scale of 1 to 5, where 5 is highest) measures performance against recognized best practices in purchasing and supply management.
[2] Overall performance calculated as average over 3 most recent fiscal years of standardized savings from purchasing and supply management, reduction in costs attributable to production of goods sold (COGS), and EBITDA (earnings before interest, taxes, depreciation, and amortization) margin.

Source: 2006 McKinsey–Supply Management Institute (European Business School) survey of purchasing executives at >200 companies

at the low performers believed that their CEOs viewed purchasing as a limited support function, and nearly two-thirds saw little indication that this mind-set would change. In our experience, such attitudes discourage purchasers from exploring new practices or ideas that might create value. Indeed, among low performers, only 11 percent of the purchasers felt that their efforts contributed to a culture of continuous improvement within the company, compared with 62 percent of the purchasers at the high performers.

Finally, high performers were more likely than the other companies to involve purchasing executives more broadly in business planning—a form of influence that, in our experience, improves decision making. Eighty percent of the top companies involved purchasing executives during the concept phase of product development, for instance. In 90 percent of the top companies, purchasers actively engage with sales and marketing executives—for example, to explore how innovations by suppliers might inform new products or services. This influence extended to M&A: top companies were twice as likely as low performers to involve purchasing in due diligence before a merger and in activities to capture value after one.

Our findings reinforce the view that while processes and technology are important, by themselves they are not enough to improve a company's purchasing performance. Indeed, we found the effect of such systems and tools to be minimal in explaining the differences in the financial performance both in procurement and overall among the respondents' companies. In our experience, creating a high-performing procurement organization starts with managing people, not processes. Companies that begin by focusing on the skills of purchasers and by encouraging

collaboration between purchasing and other functions often find that the benefits include not only lower costs but also higher-quality products, greater innovation, and more value from M&A. Reaping such benefits will be increasingly important as the pressures of globalization intensify.

Nicolas Reinecke is a principal in McKinsey's Hamburg office, **Peter Spiller** is a principal in the Frankfurt office, and **Drew Ungerman** is a principal in the Dallas office. Copyright © 2007 McKinsey & Company. All rights reserved.

[1] For the purposes of this article, financial performance comprises annual savings from purchasing and supply management, annual reduction in cost of goods sold, and the average margin of earnings before interest, taxes, depreciation, and amortization (EBITDA).

[2] We surveyed 202 companies operating in Africa, Asia, Europe, and North and South America in automotive and assembly, chemicals, consumer packaged goods, energy and utilities, financial services, high tech and telecommunications, materials and construction, pharmaceuticals, retailing, travel and logistics, and transportation. Seventy percent of the companies had revenues exceeding $5 billion. Twenty-four of the respondents represented large, autonomous business units organized in holding-company arrangements under a parent company. For the purposes of this research we treated these organizations as discrete companies.

[3] The results were valid at a 95 percent confidence level.

[4] Average savings over the three most recent fiscal years.

[5] Earnings before interest, taxes, depreciation, and amortization.