

For Direct Procurement, Speed Chess Will Be the Name of the Game

Unlike indirect procurement, where the focus is on disruptive technology, the future of direct procurement will be about maximizing power in supply markets, creating customer value, and remaining agile.

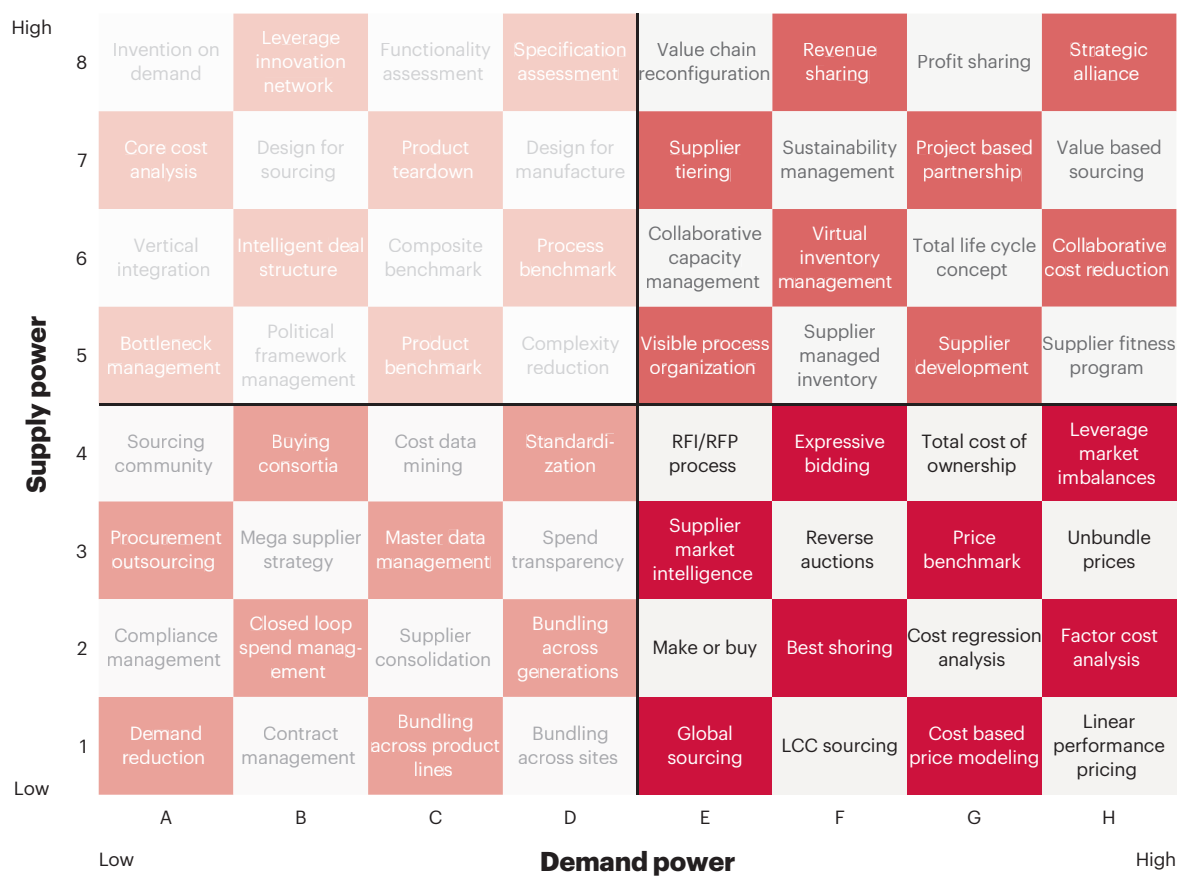


Many of the exciting advances in procurement technology—from advanced analytics and blockchain to artificial intelligence and the Internet of Things—will disrupt indirect categories such as marketing, maintenance, and facilities, where spending tends to be unstructured and fragmented with a myriad of people across functions making purchases. Because many companies today still use manual processes for indirect expenditures, digital technologies will radically transform the way these purchases are made.

But when it comes to direct expenditures, procurement technology will not have quite the same impact. Spending on products that are part of the bill of materials tends to be much more structured with clear specifications, costs that are captured in the accounting system to enable inventory valuation, and strong controls. Technological and macro changes will trigger radical shifts in manufacturing and greater information transparency through digital innovation. However, these broad changes are coming from beyond procurement—shifting the balance of power between supply and demand. For direct buyers, preparing for and taking advantage of these shifts will be the essential. The winners will be those that tackle direct procurement like a strategic game of speed chess (see figure 1).

Figure 1
Buyers are gaining power

The Purchasing Chessboard™



Note: LCC is low-cost country.
Source: A.T. Kearney analysis

Direct Buyers Will Gain Power

Relative supply and demand power is fundamental to direct procurement—determining category strategies, influencing the leverage one has over supplier behavior, and playing a role in determining profitability in direct supply chains. A.T. Kearney’s Purchasing Chessboard reveals a number of factors that determine power, such as the relative concentration of suppliers and buyers, barriers to entry in the supply market, and substitute products.

Over time, two factors regulate the balance of power: suppliers’ ability to create and maintain the uniqueness and scarcity that buyers need and buyers’ ability to find alternative ways to meet their needs and challenge suppliers’ uniqueness and scarcity. This is a love–hate relationship. Direct suppliers need to perform well to effectively meet their customers’ needs, while suppliers may also be selling to the competition. Exclusivity is a chimera that is rarely maintained forever. In the long run, a variety of players along the supply chain are vying with each other to increase their relative power.

How This Could Play Out

The dynamics of this jockeying for position are changing, fueled by macro trends in production automation and information transparency—forces that are coming from beyond the procurement world. The predominant impact is that buyers in most direct markets are becoming more powerful. This shift in business-to-business markets mirrors what is happening in many business-to-consumer markets, where the buyer is king and traditional businesses are being disrupted. These shifts are making their way through the supply chain in a domino effect (see figure 2).

Consider this example from the automotive industry. The car of the future will be automated with no driver. Rather than buying cars, consumers will use digital technology to share them and pay for usage when they need a car to take them somewhere. Automobile manufacturers will become service providers with fleets of cars rented by the hour, either directly to consumers or via intermediaries. Consumers will be able to use a brand one day and then switch to another the next. They may not even care which brand they are using. As a result,

Figure 2
Technology is causing a domino effect in supply chains



Source: A.T. Kearney analysis

automakers' power to create an aspirational brand and achieve premium prices will be much lower than it is today unless they offer genuine customer value in the process.

Now consider the upstream tiers of the automotive supply chain. Changes in manufacturing technology mean that the 3D-printed car is not far away. Today's upstream automotive suppliers have a built-in competitive advantage from sunk assets that are expensive to replicate, such as stamping, forging, and machining equipment. But as 3D printing technology evolves and as automation becomes more inexpensive, the barriers will shrink, the dynamics of the make-versus-buy decision for manufacturers will change, and doors will open for new players to enter the market. As automakers lose power with consumers, they will gain it with suppliers.

Predicting the Next Move

For buyers grappling with inflation and long-term concerns about scarcity and labor-market demographics, this may all seem counterintuitive. However, their relative power along direct supply chains will increase over time. Three considerations are essential:

Suppliers' uniqueness and scarcity will be harder to sustain

Manufacturers will continue to face the disruptive force of technology. Ultrafast 3D printing is one of the most ubiquitous disruptors, but other technologies are emerging, including light-based manufacturing, embedded metrology, and simulation. Wider digital developments also mean that knowledge will be disseminated faster, and the ability to replicate innovative designs in a way that does not infringe copyrights, patent laws, and other forms of intellectual property protection will increase. This is reducing suppliers' ability to create an enduring, inherent uniqueness and scarcity, and intellectual property is becoming harder to maintain. To retain business, suppliers must be able to innovate and improve their performance on cost, quality, and responsiveness. The most successful innovations will target consumers' needs and ideally be co-created with them to ensure the product or service hits the mark.

Buyers will find it easier to obtain alternatives

Suppliers' ability to find and use alternatives from the supply market is growing. The digital tools to find new suppliers are better than ever and can be deployed systematically. Even more importantly, though, the ability to analytically understand specifications is stronger. As recently as 20 years ago, many buyers had to rely on hand-produced drawings that were hard to analyze and often difficult to locate. Better tools to analyze and digitize drawings, break down specifications parametrically, and communicate the requirements in a way that can be competed with a wider supply base are becoming more commonplace.

Product teardown is also becoming more systematized, enabling buyers to challenge specifications and open new supply markets with product redesigns. For example, in teardown labs, industrial engineers and associated experts disassemble products to identify the individual components. The list of components then enables a company to develop fact-based insights into the quality, materials, and processes that competitors are using to make their products or particular elements of the company's own products. These lists can then be used to lower costs, rationalize a portfolio, or pursue new opportunities. This can be done, for example, by optimizing the mix of ingredients to reduce costs based on commodity pricing or changing

packaging to improve the package-to-product ratio. As a result, buyers are gaining power. The crucial question is whether they can wield this power effectively and take advantage of the available alternatives.

Although the impact will not be uniform across supply chains, the direction of travel is clear

Suppliers' power will endure in some areas, especially if they have preferential access to prime commodities that are both desired and in short supply. However, the forces of innovation will be disruptive. For example, because mined diamonds have come under intense regulatory and social responsibility scrutiny, companies are being challenged to use synthetic alternatives in industrial applications as well as for consumer use.

Other industries may be more reluctant to embrace new alternatives and take perceived risks that will challenge the status quo in the supply market. For example, the aerospace industry has long product life cycles and is understandably highly risk averse given the overwhelming need to put safety first. Incumbent suppliers will retain a large degree of power. This is based on the stickiness of buyers and the challenges of replicating a suppliers' intellectual property. In the aerospace industry, much of the supplier uniqueness is based on custom and practice knowhow that is hard to systematize and scale easily in a world of low-volume manufacturing.

Contrast this with the high-tech industry, where multiple generations of products are launched within the lifetime of one airframe or engine. High volume also enables a more systematized approach in which suppliers can be commoditized more easily unless they genuinely innovate and force the performance curve. And yet, even the aerospace industry is changing as it converges with the high-tech industry. Suppliers' ability to retain residual power will be greater here than in many other faster-moving and less risk-averse sectors. Although the relative positioning of industries is not an exact science, figure 3 (on page 5) aims to do precisely that to indicate the speed with which these changes can be expected.

Other factors will also affect the speed of these changes. For example, tariffs and other government restrictions may enable some suppliers to insulate themselves for a time. Rules that seek to limit the ability to recreate intellectual property may also be involved. These will delay but not change the underlying domino effect as buyers' power increases across the supply chain.

Suppliers Will Not Surrender

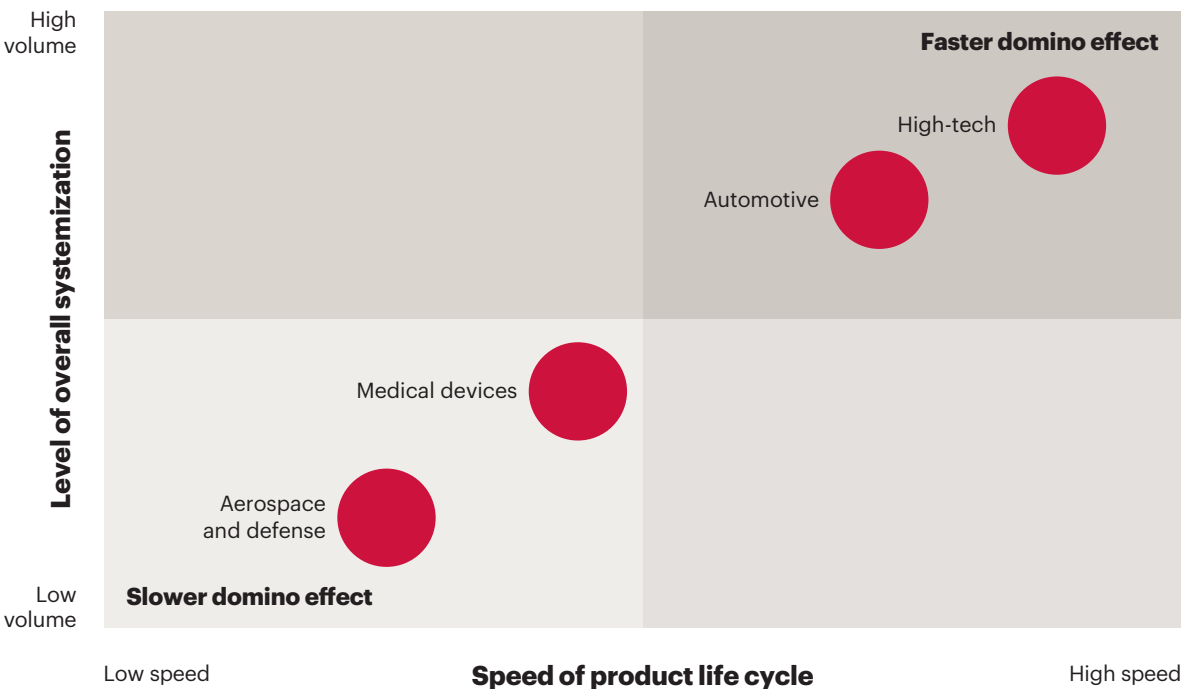
Constant improvement and innovation are the only mantras for suppliers' long-term success. Although erecting walls as impediments will not be a sustainable option, this will not stop many suppliers from trying to do just that. There are a number of ways they will try to resist the reduction in relative power. Some will attempt to move upstream to get closer to scarce commodities that they hope to control, and some will seek artificial ways to keep power by using tariffs, regulations, and restrictions on using intellectual property. Recent election campaigns in many western economies have highlighted these trends.

Many manufacturers have already moved into providing services associated with their products, such as maintenance, outsourced machine operations, and even selling their data as a product. The growing ubiquity of digital and the Internet of Things means that data is a tempting competitive weapon. This has tended to increase supplier power by making buyers less keen to

Figure 3

Buyers will become more powerful in high-volume industries with fast product life cycles

Illustrative



Source: A.T. Kearney analysis

switch and appears to be part of a response to manufacturing becoming less unique. Expect to see more suppliers going down this path and inflating the value of the services and data they provide as a way to create stickiness.

Buyers Need a Ruthless Focus on Gaining Power and Using It

In the future, buyers' overall relative power will increase, but an individual buyer's decisions will affect the degree to which he or she can gain power and then use it. This will require playing a long-term game that homes in on capturing relative power. At the same time, buyers will need to be nimble to take advantage of new opportunities—seeking alternatives while never losing sight of the big picture.

There are three practical ways to do this:

Retain open choices. As much as possible, remain unconstrained in the supply market. Be prepared to sacrifice short-term gains at the expense of the longer-term ability to retain free decision making. Also, seek to avoid lock-ins with suppliers as part of a multiyear approach.

Strategically manage intellectual property. Retain or take control of the intellectual property needed to wield power in the supply market and compete in the product market. Be especially

Careful with respect to key design rights and ownership of drawings, specs, and data. Avoid suspending commercial judgment and getting carried away with the strategic relationship.

Leverage supplier innovation. Consider the alternatives, and develop ways to improve your competitiveness by taking advantage of supplier-driven innovation. Selectively invest in suppliers that can bring game-changing innovations. Be prepared to create exclusive supply agreements with vendors, but maintain control of the intellectual property that creates a competitive advantage.

The dynamics of the future mean that buyers will need to be more agile in how they deploy techniques to take advantage of the opportunities and the domino effect of their escalating power.

These recommendations are in line with today's best practices for direct procurement. And yet, the dynamics of the future mean that buyers will need to be far more agile in how they deploy the techniques to take advantage of the opportunities and the domino effect of buyers' escalating power. The Purchasing Chessboard will still be relevant, but it will need to be deployed on steroids—like a tactical round of speed chess.

Apple Has Already Made the Next Move

In many ways, the high-tech industry is already pointing to the future of direct procurement across supply chains. Apple is a good example, having used its supply chain to create a huge competitive advantage.¹ A significant part of the iPad's success can be traced to the exclusivity arrangement the company created with Corning's Gorilla Glass before the product became a blockbuster. This left competitors years behind in the tablet market and is a classic example of leveraging supplier innovation in a smart way.

Apple also invests in constructing supplier factories to manufacture components such as touchscreens, chips, and LED displays. This includes Apple's \$5 billion advanced manufacturing fund.² In return, Apple receives exclusive rights to the products that those factories produce, keeping competitors at bay by deterring access to these essential assets. And all the while, Apple can charge a premium for its products. When competitors eventually catch up, Apple is ahead of the game—producing the product cheaper and capturing more profits. Then, the cycle starts again in a process of constant innovation in manufacturing, design, and process where no members of the supply chain can erect permanent walls to protect their position but must constantly improve.

Apple does not appear to be sentimental about these arrangements and strategically avoids getting locked into supplier relationships. Relative demand and supply power are actively

¹ "How Apple Became a Monopsonist," *Fortune*, 5 July 2011

² Apple press release, 17 January 2018

managed, as is the key intellectual property needed to compete. The recent dispute between Apple and Imagination Technologies is a good example. Imagination was a longstanding supplier of technology for the graphics processing units (GPUs) in Apple’s mobile devices. GPU intellectual property is obviously essential, and Apple has developed its own technology, ending its use of Imagination’s technology.³ This business-focused and unsentimental behavior is a prime example of pursuing open choices and managing key intellectual property. This approach is not all that surprising, given that Apple CEO Tim Cook has a background as a supply chain leader.

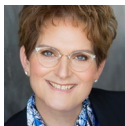
Mastering the Game

The future of direct procurement is an unambiguous good-news story that has ongoing relevance. The core skills and tools of direct procurement will become more pertinent than ever. Businesses and their buyers that can master these will have a strong competitive advantage.

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³ “Imagination Technologies Deal Ends Run as UK’s Bright Spark,” *Financial Times*, 3 November 2017



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