Competitive Advantage through Strategic Global Sourcing

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Consulting Supply Chain Management Professional (CSCMP)

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Competitive Advantage through Strategic Global Sourcing and Procurement Transformation

- **Building strong Global Procurement Capabilities through Procurement transformation**

- **Driving a high value strategic sourcing approach in a global environment**

- **Focus on innovation and early involvement to leverage procurement capability and synergy**

- **Best Cost Sourcing - Geo Comparison**
IBM 2010

Industry Sectors & Revenue

- Global Services 56%
- Software 23%
- Hardware 18%
- Global Financing > 2%
- Enterprise Investments/Other < 1%

People

- 426,750 Employees Worldwide
IBM in Hungary since 1936

IBM - Hungary
Continuously in Hungary since 1936

ISC Hungaria
Outsourcing activity

IBM Storage Enterprise Server
Manufacturing in Vác since 1996
Products manufactured, single sourced, in Hungary

San Volume Controller (SVC)  DS 8000

SSPC
Prior to the 1990’s, Procurement was considered an “underdog” in most corporate cultures

- Not highly valued by the top of the business

- Considered a bureaucratic and paperwork intensive function

- Certainly not a glamour job… not on the career path of most future CEOs

How did Procurement emerge from it’s underdog status to become an important corporate function?
IBM Procurement... Then

IBM Procurement environment in the early 1990’s

<table>
<thead>
<tr>
<th>Organization</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Decentralized</td>
</tr>
<tr>
<td>• End user dissatisfaction</td>
</tr>
<tr>
<td>• Maverick buying</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>People</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Generalists (lacked sourcing expertise)</td>
</tr>
<tr>
<td>• Tactical focus</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Process</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Inconsistent</td>
</tr>
<tr>
<td>• Paper intensive</td>
</tr>
<tr>
<td>• Lacking leverage</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Technology</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Patchwork of legacy systems</td>
</tr>
<tr>
<td>• Lacking basic spend info</td>
</tr>
</tbody>
</table>
IBM Procurement Transformation

Starting in the early 1990’s, Procurement began a journey that continues today to reinvent itself to increase its impact and relevance to IBM as a business.

- **1993** ... **1995** ... **1998** **1999** ... **2002** ... **2007+**

**PHASE**

- **Establish Foundation**
  - Established organization and governance and initiated Sourcing Councils

- **Enterprise Transformation**
  - Developed common processes and implemented enabling technologies around the world

- **e-Business**
  - Established true external electronic collaboration with suppliers and partners

- **Integrated Supply Chain**

**Procurment JOURNEY**

**THEN**
- Fragmented and not mission critical
- Procurement organizations in various business units
- 66,000 suppliers
- People spend majority of time on execution & fulfillment
- Patchwork IT infrastructure with legacy systems

**NOW**
- Drives value
- Global procurement operations across all IBM
- Reduced number of suppliers by half; formed fully integrated/strategic partnerships partners
- Professionals spend majority of time on supplier evaluation and market understanding
- e-Procurement infrastructure extends beyond enterprise for seamless data management

**Cost Cutting** → **Reinvention**
The Way IBM Optimized its own Procurement has been acknowledged Internationally

<table>
<thead>
<tr>
<th></th>
<th>Early 90s</th>
<th>Today</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bypassing procurement processes</td>
<td>30%</td>
<td>&lt; 0.5%</td>
</tr>
<tr>
<td>Ordering process time</td>
<td>30 days</td>
<td>1 hour</td>
</tr>
<tr>
<td>Frame Agreement terms</td>
<td>6-12 months</td>
<td>30 days</td>
</tr>
<tr>
<td>Average No. of agreement pages</td>
<td>40+ pages</td>
<td>6 pages</td>
</tr>
<tr>
<td>Electronically interfaced vendors</td>
<td>0</td>
<td>33,000</td>
</tr>
<tr>
<td>Error rate</td>
<td>&gt; 30%</td>
<td>&lt; 5%</td>
</tr>
<tr>
<td>Internal satisfaction with Procurement</td>
<td>40%</td>
<td>82%</td>
</tr>
<tr>
<td>Procurement process costs</td>
<td>2%</td>
<td>&lt; 1%</td>
</tr>
</tbody>
</table>

Winner of MIT Sloan School award for transformation of Procurement and Payables

Winner of Purchasing Magazine Medal of Excellence
At the heart of the organization are Category Sourcing Councils

1. Industry Intelligence
2. Procurement Metrics
3. Competitive Evaluation
4. Market Analysis

1. Technology convergence
2. Early Supplier Involvement
3. Supplier Development
4. Qualification

Global Supplier Base
Sourcing in Low Cost Geos

“The World Is Flat”

By Thomas L. Friedman

“When everything is connected, work moves… the work of business and the work of technology. Work flows to the places where it will be done best”

Sam Palmisano, INSEAD October 3, 2006
Product Life Cycles are constantly shrinking

Life cycles are shrinking from years to quarters resulting in:
- high ramp up risk
- short volume production
- need to plan and execute phase out very professionally
2010 Corruption Index Map

THE 2010 CORRUPTION PERCEPTIONS INDEX MEASURES THE PERCEIVED LEVELS OF PUBLIC-SECTOR CORRUPTION IN 178 COUNTRIES AROUND THE WORLD

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IBM Supplier Conduct Principles

IBM is committed to doing business with Suppliers who are environmentally responsibly & encourages environmental awareness with these suppliers

- Forced or Involuntary Labor
- Child Labor
- Wages and Benefits
- Working Hours
- Nondiscrimination
- Respect and Dignity
- Freedom of Association
- Health and Safety
- Protection of the Environment
- Laws, Including Regulations and Other Legal Requirements
- Ethical Dealings
- Communications
- Record Keeping
Covalence Ethical Ranking
(Looks at a universe of 581 Companies and ranks them on Ethical Behavior)

1. IBM
2. Intel
3. Cisco
4. Pepsi
5. Unilever
6. Marks and Spencer
7. Xerox
8. General Electric
9. Dell
10. HSBC
11. Google
12. Procter and Gamble
13. Verizon
14. AT&T
15. Alcoa
IBM’s worldwide procurement organization is adding more strategic procurement people in Low cost countries.

Transform more strategic positions from **high cost** to **low cost countries**.
Delivery of Savings
Why is IBM confident that we can deliver savings??

People
- Experience
- Expertise

Process
- Sourcing Strategies
- Structured Sourcing Process

Technology
- Spend Analysis
- Advanced Sourcing technology

Leverage
- Market Intelligence
- Aggregation and Leverage
- Compliance
Supplier Segmentation
We focus on rationalizing the global supply base to establish sustained competitive advantage

Supplier Relationship Segmentation

<table>
<thead>
<tr>
<th>High</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value Of Purchases</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Regional / Niche</td>
<td>Strategic / Core</td>
</tr>
<tr>
<td>Suppliers that may be specific to a region or a unique product or service</td>
<td>Self-sufficient, world-class provider</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Strategic / Tactical</td>
<td>Emerging</td>
</tr>
<tr>
<td>Low impact and $ value</td>
<td>New technology / product differentiation</td>
</tr>
</tbody>
</table>

Target: 90% of spend
IBM implemented PCA to measure procurement’s contribution relative to the marketplace

✓ Procurement Competitive Advantage (PCA) measures the difference in actual price paid by IBM versus industry price changes

✓ PCA shows our buying performance relative to the marketplace

Example:
A 15% IBM price reduction in a given commodity versus an industry price reduction of 10% would yield a 5% PCA measurement
Everyone is talking about innovation as the key to success

“Constant reinvention is the central necessity at GE... We're all just a moment away from commodity hell.”

Jeffrey Immelt
Chairman and CEO, GE

“We will fight our battles not on the low road to commoditization, but on the high road of innovation.”

Howard Stringer, Chairman and CEO, Sony Corporation
Oct. 4, 2005

“More and more CEOs are adopting an innovation agenda.”

Sam Palmisano
IBM Board of Advisors
Oct. 13, 2005

“Electronics Industry Lacks Innovation, Philips CEO Charges”

EE Times, Sept. 27, 2005

“Innovation continues to be a key driver in the success of our business.”

Tom Taylor, Executive VP of Merchandising & Marketing, Home Depot, Aug. 20, 2005
Innovation for Driving Procurement Upstream

**Procurement involvement**

- 70%
- 20%
- 5%
- 5%

**Additional Cost reductions**

**% influence on manufacturing cost**

- Design: 70%
- Material: 20%
- Labor: 5%
- OVH: 5%

**% of product cost**

- Design: 5%
- Material: 60%
- Labor: 15%
- OVH: 20%
Total Cost of Ownership Perspective

Price is often just the tip of the iceberg!

**TCO considers all costs not just price!**

Total Cost = Unit Cost + Transportation + Logistics + Warranty + Supply + Quality
Manufacturing – Global suppliers with local presence
Reduction of unnecessary transportation

IBM as a globally integrated company manufactures under best cost country aspects. This requires partners that can fulfill the same requirements globally.
Eastern Europe's (EE) supply base starts to evolve (1)

- It may take awhile, but EE will eventually become a viable source for electronic components and other production material.

- Many OEMs & EMS already have manufacturing in MEE & EE. Companies have to import many components, but a supply base is developing around low-tech items such as Cable Asm, Racks, Enclosures.

- However, the supply base for production materials such as Semiconductors, Liquid Crystal Displays and other electronic components will take a while to develop.

- A supply base in EE has to be cost competitive, produce the same level of quality and in volumes OEMs and EMS need. If a EE supplier can’t do this why would companies use those suppliers?

- It may be that the continuing influx of Global Suppliers will form the basis of a supply chain in these EE countries.

(1) Jim Carbone, Executive editor, Electronics, Purchasing Magazine 1/26/2006, Ian Crawford, VP of Global Sourcing IBM
BEST COST SOURCING SOLUTION

Probably the best and most effective Low Cost Sourcing solution is building in the region for the region, *each region has a low-cost solution* – Mexico for the Americas and Eastern Europe for Europe!
Thank you!

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