Sourcing Governance 2030

A study of trends by the KPMG Wirtschaftsprüfungsgesellschaft and the procurement leaders

What is sourcing governance?

how secure is my supply chain?

are my suppliers compliant?

what should I know about tier-n suppliers?

how sustainable should my supply chain be?

how much transparency is enough?

Sourcing governance in 2030 will be ...

Ganzheitlich in die Zukunft steuern
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Let’s not beat around the bush – is sourcing governance just another bit of hype in the long list of management fads? Another buzzword or, at best, old wine in new skins? To be honest, some of the participants in this study actually do consider sourcing governance to be something along those lines. Researchers, consultants and authors of management handbooks are frequently enough suspected of first creating a need and challenges only to then sell the unsettled client and readers the appropriate solutions.

To be honest, this objection cannot be completely dismissed. But at the same time, it is the duty of consultants to sensitize their clients to new subjects and provide them with the knowledge and resources that the client cannot provide themselves due to organizational circumstances, a lack of time and a lack of comparative opportunities to other companies and sectors.

Quite a number of these subjects hold a great potential for transformation and are of critical importance for the survival and success of companies. We are convinced that sourcing governance also has this potential. In a highly networked and globalized world in which the depth of added value is constantly sinking, while volatility and fragility is constantly increasing, the boundaries of companies are of absolutely no matter; without the partners in the value chain it will hardly be possible to deal competently with the megatrends of the coming decades. It is unlikely that any company will be in a position to defend its innovativeness and competitiveness, and control its economic, legal and ecological risks single-handedly. Without the close involvement of its strategic suppliers it will not be possible to meet the highly complex customer requirements regarding quality and efficiency.

Collaboration in international supply networks in 2030 will therefore be significantly closer and more intensive than it is today. Steering these will require new methods and instruments as well as a general strategic approach that monitors the mutual success of companies and their suppliers. It will require sourcing governance. We are convinced that this will be a decisive factor in the future when considering the value of a company, the savings potential that can be realized and the access to the best suppliers and, consequently, the best know-how.

This study casts light on the current and future challenges in value chain management and the agenda of companies in the introduction and implementation of all the relevant aspects of sourcing governance.

As the authors we wish to express our appreciation to the study participants who offered us insights into their strategic considerations and we wish you enjoyable and informative reading.

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Sourcing governance is generally considered to be the responsible management and controlling of the external value chain and therefore focuses on the entire external supply chain of a company. This is associated with the acceptance of the responsibility for the proper and value-creating legal, economic, ethical and ecological actions of every supplier and pre-supplier.

The increasing attention being given to sourcing governance is based on four primary causes:

1. The principle of attribution, in which a company is held liable for the violations of its suppliers, is becoming ever more prominent around the world. Examples of this are new legislation and stock market regulations for dealing with conflict minerals such as the US Dodd-Frank Act, the London Bullion Market Association (LBMA) and the UK anti-corruption law, the Bribery Act. Changes in the German Corporate Governance Code as well as new and amended sector-specific laws and codes indicate similar developments are in the making.

2. Public perception is changing: Especially ecological, ethical and labor-law violations by suppliers may result in massive harm to a company’s reputation. As a consequence, investors and analysts are no longer assessing companies only on the basis of their economic development and their internal compliance systems, but also with regard to the corporate culture they live and the efficiency and effectiveness of the control mechanisms directed at the supply chain, mechanisms that frequently display significant weaknesses.

3. The increasing integration of the worldwide value chains as one of the economic and structural frameworks also leads to an integration of the risks: High price fluctuations, supply bottlenecks, environmental disasters, political or economic instability as well as cyber-terrorism may destroy the entire supply chain if they only affect a single critical link in the chain.

4. Last, but not least, sourcing governance also aims at the systematic utilization of opportunities in the supply chain: Especially at the innovation potential, the knowledge of local markets and specific expertise or logistics know-how of the suppliers. Turning this knowledge into a strategic competitive advantage for the own company is the success secret of the concept.

How do companies assess the relevance of sourcing governance with respect to the year 2030? What role does the approach play with regard to dealing with megatrends and the demands for transformation in the coming years? What do the best practices in the external value chain and sourcing governance look like? Where will the greatest need for action be in the coming years? We sought answers to these questions in the framework of this study.

To accomplish this, we surveyed a total of 136 international companies from various industries in a mixture of personal interviews and questionnaires. All the study participants were members of the top management and decision-makers in their companies. The surveyed organizations were exclusively major corporations; 75 percent had sales of at least 500 million euros and 80 percent had more than 1,000 employees.

The results of the study are nevertheless very relevant for small and medium-sized companies as well – study results and project experiences of the last few years have repeatedly demonstrated that the legal, organizational and financial challenges for major corporations exist as well for small and medium-sized companies – with a tendency to be even significantly stronger in their impact.
There is a direct interaction between the development of a well-founded and effective sourcing governance strategy and deeply-seated and sustainable developments that will impact on value chain management till 2030. The study participants identified a number of areas that are closely related to one another and will exhibit enormous pressure for transformation for their industries in general and their companies in particular over the course of the coming decades:

- Increasing importance of collaborations and alliances
- Expansion of the local-for-local approach and increasing relevance of growth markets
- Greater legislative constraints and increased compliance requirements
- Threatening scarcity of resources
- Significant market consolidation
- Rapid increase in the need for flexibility with regard to costs and processes.

Within the framework of the study, it was possible to determine the essential issues within these areas that will intensively occupy companies – with regard to their external value chain and based on the year 2030.

**Joint ventures and alliances**

According to the study participants, the major importance of collaborations corresponds, on the one hand, with the decreasing depth of the value chain in the coming years. This will make an increasingly close cooperation with strategic suppliers unavoidable and their contribution to the overall success of the company increasingly critical. At the same time, the companies also consider consolidation processes on the supplier side to be likely and consequently an overall gain in power on the part of some suppliers. The relevance of the vertical integration or targeted acquisitions in critical points along the supply chain will also increase until 2030. On the horizontal plane, the study participants also expect new, in some cases cross-sector, strategic alliances that will play an especially important role where it is necessary to secure the availability of scarce raw materials.

**Shifting of the power bases in growth markets**

The macro-economic megatrend of the last few decades – the shift of demand and increasingly supply as well to the growth markets – will continue in the opinion of the surveyed decision-makers. This development will have a number of implications for the management of the external value chain.

One the one hand, the customization of the supply chain will change. A much greater portion of the value-added activities will shift to the vicinity of the booming demand markets and production sites in Asia and Latin America. In view of this, sourcing and production processes for local demand markets will be a matter of course in 2030. The gain in economic and political power that Asia and Latin America are experiencing is also expressing itself in the growing strength and competitiveness of the local suppliers, making the “away games” of western competitors increasingly challenging. Subsequently, the efforts to act not as an exporter, but rather also as a local provider in the target market will become significantly more intensive.

**Compliance and regulation**

The last few years have shown an enormous expansion of regulations worldwide. Many reforms are confronting companies not only with great legal dynamics and complexities, but are also forcing them to monitor their own companies as well as their entire supply chain and to organize them so as to become compliant. The persons surveyed expect that this trend will continue, in particular increased environmental controls and greater regulation of critical processes (for instance in wood processing or energy trading) are seen as very serious challenges with regard to 2030.

**Scarcity of resources**

Another subject that the majority of the persons surveyed agreed will play a critical role for their sector or company in 2030 is the scarcity of strategically important raw materials. This affects, on the one hand, the metals needed for industrial production, renewable raw materials as well as synthetic materials the scarcity of which combined with a simultaneous increase in demand does not represent an
improbable scenario. On the other hand, the scarcity of intangible resources, in particular the know-how that makes a competitive difference, access to patents and innovations will be a central challenge of the future. Accordingly, the safeguarding of critical resources is considered to be one of the most important tasks. Parallel to that, the study participants also expect that the reduction of the use of materials in production and an optimization of resource management will have a significantly greater strategic relevance than is the case today.

**Market consolidation**

The global competitive landscape will have altered significantly by 2030 according to the persons surveyed. The material drivers of this development will be the suppliers from the growth regions that are generating a massive amount of pressure on the established market structures. One consequence of this development the study participants consider likely is a comprehensive market consolidation at all levels of the value chain.

In this context, it is to be expected that new oligopolistic procurement markets will develop, for instance for renewable raw materials such as cocoa and rubber. But mergers and a market shakeout are also conceivable in the production of industrial goods and semi-finished products. The shift in power to the suppliers will therefore make it necessary to establish new strategies and forms of cooperation.

**Flexibilization**

In view of the rapidly decreasing ability to plan for the long term and the necessity to be able to adapt quickly to changes in general conditions and major market fluctuations, the decision-makers surveyed consider the flexibilization of costs and processes as another long-term trend that will clearly define the external value chain in 2030.

This affects, on the one hand, the operating processes and the possibility to flexibly use both the own installed capacities as well as the suppliers’ systems within an adaptive production network. On the other hand, especially flexibilization of the fixed costs will become a strategic imperative by 2030, so as to control the financial risks in an increasingly opaque and volatile global economy.

An additional, important dimension in this context is the ability to be able to adapt to new geopolitical constellations. The changing political players and governmental structures impact significantly on the pattern and the geographic extension of the supply chains and will demand a high degree of adaptability on the part of companies.

Beyond the top trends, the study participants also expect that the following developments will be relevant up to 2030: The digitalization of the supply chain, the orientation of sourcing and production according to sustainability criteria and the battle for talent resulting, amongst other things, from demographic changes. Nevertheless, the majority of the study participants consider the potential for transformation of these developments to be less important with regard to their external value chains.
How well are companies prepared?

How well do the companies feel that they are equipped for the changes described? The majority of the decision-makers surveyed assume that the uncertainties will increase significantly till 2030. On a scale of seven, the study participants agreed to this statement on an average ranking of six. At the same time, the study participants think it is likely that the supply chains in their specific industries will have fundamentally changed by 2030 and the depth of the value chain will sink to below 50 percent.

In view of such great strategic uncertainty, the companies are only somewhat well-prepared. Neither with regard to the precise knowledge of the most important trends in the global value chain nor with regard to the preparation for these developments do the majority of those surveyed see themselves as well-equipped.

Fig. 1: Assumptions about added value in 2030

<table>
<thead>
<tr>
<th>Statement</th>
<th>Completely disagree</th>
<th>Agree completely</th>
</tr>
</thead>
<tbody>
<tr>
<td>The uncertainty (i.e., the degree of complexity and dynamics) in the industrial environment will continue to increase till 2030.</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>Our company precisely knows the trends of added value till 2030.</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>Our sector is very well-prepared for the long term.</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>The value chain for our sector will undergo fundamental change by 2030.</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>Our company will have an added value depth below 50 percent in 2030.</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>Our company is sufficiently well-prepared for the coming added value trends.</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
</tbody>
</table>

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Need for Action and Reaction Strategies

How are the surveyed companies preparing themselves with regard to the trends described? The primary measures can essentially be classified in four categories which the decision-makers surveyed are focusing on.

Transparency & integration: Strategic supplier management

The expected changes in the general conditions and structures of value chain management are moving suppliers to the center of the companies’ considerations. The study participants especially have a sense of urgency with regard to the establishment of new processes for the inclusion of suppliers and the strengthening of long-term supplier relationships. Parallel to that, a lot of emphasis is being placed on the strategic qualification of the suppliers – which is absolutely essential for the majority of the decision-makers, especially in view of the decreasing depth of added value and the close integration of the supply chain.

The major importance that is attributed to supplier management is not, however, only to be found in the challenges of the future, but also in the current situation. Only 27 percent of the parties surveyed achieve more than half of the annual cost reductions in collaboration with their strategic suppliers and the prognosis for the coming years does not indicate any essential changes.

In view of the prospects of lower added value depth on the one hand and the increasing price and cost competition on the other hand, these figures indicate a sense of urgency. No company will be in the position to sustainably reduce costs without extensively including the potential to be found in its value chain. The prerequisite for this is the establishment of deep, strategic relationships with the suppliers. By the same token, the study participants report that they are a long way from entertaining such partnerships to the degree they are required. More than 60 percent of the persons surveyed have a strategic, added-value generating relationship with one in four of their suppliers. According to the estimates of the participants, this situation will only change slowly in the coming five years.

Fig. 2: Joint cost management with strategic suppliers
In view of this, the companies see a comprehensive need for action, especially with regard to the establishment of supplier relations in terms of a win-win approach. The essential factors of this approach are the intensification of the cooperation, for instance, from the perspective of resources and supply aspects and a greater integration of the suppliers in the implementation of customer requirements up to and including direct delegation of topics to tier-1 suppliers.

Due to the fact that suppliers will have to assume significantly more responsibility in the course of this development, the companies are increasingly focusing on the transparency and controllability of their external supply chain management. Along with the establishment and the implementation of effective systems for the measurement of controlling, monitoring and performance – both for supplier audits as well as for the steering of the cross-company supply chain processes – the persons surveyed are planning a material expansion of the tier-1 supplier management, especially with regard to risks, costs, innovative potential and employee qualifications.

**Contract management and compliance**

The study participants assume that the intensification of the cooperation with the suppliers will result in the need for changes with respect to contracts as well. This will affect in particular the service level agreements, which, amongst other things, also contain governance and compliance expectations as well as tender compliance and the designing and assertion of an ethically correct procurement. Individual sectors, such as the automobile industry and portions of trade, have served as pioneers in establishing external and internal standards (amongst others, codes of conduct) in supply chains. The obligations to produce supporting documents, rights of inspection and other obligations will increasingly become standards. The transparency required and the feasibility of so-called compliance audits of the suppliers still require legal certainty and therefore the contractual form and agreement so as to take into account the protection of intellectual property and data security.

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**Fig. 3: Intensity of the supplier relations**

<table>
<thead>
<tr>
<th>Supplier relationship</th>
<th>The majority of the participants (ca. 61 percent) have a strategically important relationship with less than 25 percent of all their suppliers.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>&lt;25%</td>
</tr>
<tr>
<td>&lt;25%</td>
<td>61%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>With what percent of the suppliers will you entertain an important relationship in the next five years?</th>
<th>In the coming years, 49 percent of the persons surveyed reported that they will have an important relationship with less than 25 percent of their suppliers.</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;25%</td>
<td>&lt;25%</td>
</tr>
<tr>
<td>&lt;25%</td>
<td>49%</td>
</tr>
</tbody>
</table>

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Optimization of procurement and the supply chain management

The process optimization in procurement goes hand in hand with the redesigning of the strategic supply management as well as the fundamental re-evaluation of the existing approaches for steering the value chains. With an eye on 2030, the focus of the decision-makers surveyed was on two points. On the one hand, it is a matter of optimizing the interfaces of the organization so as to be able to react quickly to the market changes/opportunities arising. On the other hand, it is a matter of utilizing the expertise of procurement, in particular for the comprehensive cost-cutting programs.

Strategic raw materials management plays an exceptional role in this context. Here, procurement will have to develop strategies with other areas of the company in the coming years to safeguard the availability of raw materials and quality and to further develop alternative specifications for raw materials. This holds especially true in view of the “political dimension” of critical raw materials.

To accomplish these goals, companies expect a significantly increasing need for qualifications with regard to interfaces both within procurement as well as throughout the organization. This is especially true for the implementation of methods and instruments for steering the global supply chain, the globalization of knowledge and the establishment of strategic partnerships and joint ventures in the subjects surrounding research and development, sourcing and flexibilization of resources.

Strategic adjustment and implications for value-chain management

The trends described require adjustment processes necessary not only at the level of value-chain management, but also in the context of the overall strategy. Simultaneously, setting the strategic course for the coming years will also stipulate the general conditions for the development of the external supply chain management. The majority of the study participants foresee a significant need for focusing the strategic orientation as well as strategic business development. Simultaneously, the focus on core competences and the balancing of the portfolios should be moved forward.

These processes also imply a re-evaluation of the own added value, its geographic distribution and depth. Specifically, this means subjects such as flexibilization of the supply chain and optimization of built-to-order, global cost-reduction methods and the development of optimally suited localization strategies (best country sourcing versus localization) take on a greater priority. The shifting of added-value portions of the supply chain to growth regions plays a special role in this regard.

In the opinion of the persons surveyed, these extensive changes will place new demands on the organization. Above all, the reduction of complexity and quality assurance by means of system harmonization for integrated planning processes, the standardization and digitalization of systems and processes as well as the ensuring of process quality, through the specification of need, for instance, will take on greater importance by 2030.
Considering the trends in value chain management described in the preceding chapters, it can be assumed that sourcing governance already should, and in any case in the coming years will, belong to the corporate standard. Both with regard to the controlling of risks and safeguarding of innovative capabilities as well as with respect to the reputation and legal certainty, there is almost no alternative to a consistent implementation of sourcing governance structures. The study, however, reveals another picture.

No comprehensive transparency
With regard to the transparency of relations with suppliers the study found that:

- Only just half of the companies surveyed have established long-term goals with their suppliers and then assured their continuous monitoring.

- Every fourth study participant reported that only direct suppliers not, however, the other relevant value-chain partners are being systematically evaluated re operative and strategic performance.

- More than 60 percent of the companies currently do not check the operative performance of the pre-suppliers (tier-2 and tier-3 suppliers).

In view of this, it is surprising that only one-third of the study participants reported that they wished to increase the transparency of the pre-suppliers.

In contrast to that, there is a refined picture for the process and risk control as well as in the checking of the legal certainty. Well over half of the study participants report that the risks resulting from the supplier relations are identified early on and that the maturity of the supplier’s compliance management system is taken into consideration in selecting the supplier. By the same token, however, the majority of the companies do not apply an automated procedure for the monitoring of the maintenance of guidelines or process instructions. And while two-thirds of all companies have a code of conduct that is also compulsory for the suppliers, less than half of the study participants check to see if the regulations are adhered to.

Even more disconcerting is the situation with respect to the management of sustainability risks in the value chain:

- Only 36 percent of the companies responded that they comprehensively report on sustainability aspects, and

- Just a fifth of the study participants support the suppliers to systematically reduce the sustainability risks.

Studies in the last few years have proven that sustainability management in companies still is not given the importance that it deserves. That it remains practically unnoticed with regard to its impact on the supply chain is therefore not surprising.

Hurdles to implementation
These results lead to the conclusion that the lack of urgency granted sourcing governance is not due to a lack of knowledge, but rather primarily the consequence of problems in the design and implementation. The hurdles are, on the one hand, to be found on the process and technological plane, for instance, in the lack of a compliance management system. On the other hand, the organizational basis is often lacking for the implementation of a comprehensive sourcing governance architecture. To substantially develop this demands close cooperation between the finance, risk, compliance and procurement departments. Together they must establish the appropriate framework. This is also an absolute prerequisite for the integration of the competences of procurement and supply chain management (SCM). And that with respect to both the knowledge of the finance department about risk management instruments and processes as well as the knowledge of the value chains themselves. And last, but not least, there is a massive backlog in qualification in the procurement and SCM departments of the companies with regard to the risk, compliance and financial issues. This requires the development of structured, systematic training methods.
operational + strategic performance
process + risk control
tier-1 Suppliers
tier-2 Suppliers
transparency sub-suppliers
concept design implementation
continuous monitoring system
non-automated monitoring
The results of the study show that the companies’ sense of urgency for sourcing governance is obvious. Sourcing governance in 2030 is considered to be “a matter of course”, a “K.O. criterion for competitiveness” and “mission critical”, as a subject that must become a part of the “DNA of the organization”. That is why the decision-makers of the companies surveyed see a whole list of strategic measures that have to be implemented in the coming years so as to introduce a comprehensive and sustainable implementation and establishment of all the relevant aspects of sourcing governance.

The top topics – procurement optimization and supplier management

When drawing a roadmap for the coming two to five years, the issues of procurement optimization and supplier management take top priority. There are two routes to be pursued in this matter.

The first focuses on developing a master plan for the evolution of procurement and supply chain management. This strategic measure also requires that the subject be on the agenda of the company’s upper management. The parties surveyed consider it to be absolutely essential that the definition of the goals for the optimization of procurement be made at the group level in the future. In addition, a sufficient investment budget must be provided for:

- The centralization of procurement,
- The increasing of transparency through a higher “managed spend” ratio,
- A continuous performance metrics and
- Assessment as well as the strategic qualification and training of the staff.

The second aspect is – especially in view of the unsatisfactory status quo – in the improvement of the sustainability in procurement.

With regard to the supplier management, the study participants see a great need to increase the performance, effectiveness and efficiency of the procurement organization and to “condense” the management of the value chain network. This should be achieved with more intensive and regular communication, something like annual reviews and supplier conferences. On the other hand, the persons surveyed want to extend the supplier assessment by means of additional, primarily qualitative aspects. Parallel to these, in the future target setting systems and roadmaps as well as regular audits of the suppliers and automated monitoring solutions should serve to support the steering. In this context the decision-makers’ agenda also contains the rollout of compliance management systems and the consistent implementation of the code of conduct throughout the entire supplier network.

An additional consideration is represented by the already existing technological possibilities that allow for sourcing governance as an end-to-end method. To date, a majority of the companies have not really even begun to take advantage of this potential. Interfaces for structured forecasting are either not available or are managed sub-optimally, for instance, with regard to the working capital. To date, the customer is the missing link in an integrated, continuous sourcing governance process. Just like the supplier, in the mid-term the customer should find a permanent place in the concept and the technologically-supported implementation of sourcing governance.
If you take a look at the current political and economic map of the world, it is obvious just how much the power bases have shifted in the last few decades. Following the exclusion of Russia in March 2014, the G7 format of the group of the world’s most powerful economies has been mercilessly overtaken by economic, and increasingly by political, realities. China and Brazil have long moved into the top 8, while Canada, overtaken by India and Russia, currently holds rank 11. But not only has the economic focal point of the planet moved from Western Europe and North America toward the east and south, but the political has as well. Regional alliances and international collaboration outside of the former major powers have taken on greater importance.

An additional vector along which power is moving to the east and south is that of technological innovation. Western companies and government organizations find it ever more difficult to defend their global technological leadership. As a result of, in some cases lavish, government funding of offenses for innovation and education in China, South Korea and other Asian countries as well as strategic corporate acquisitions and participations in the west, within a few years these countries will no longer be available to Europe and the USA as subcontractors.

In order to find an appropriate long-term and strategic response to these challenges will require a new understanding of globalization in Europe and the USA. After all, it is still exports, the purchase of raw materials and the relocation of a few added-value portions of the supply chain that dominate the channels through which we open up the world. The major future markets demand a different approach. They require consistent localization, the relocation of intelligence and decision-making and the view of the innovative potential of these regions. And last, but not least, by means of intensive cooperation and a strong local presence to guarantee the supply for the European economies so poor in raw materials.

The associated close linking and integration of global value chains requires not only strategic skills, process know-how and cultural expertise. More importantly, the established strategies and instruments in financial and risk management have to be fundamentally reconsidered. From this perspective, sourcing governance is taking on greater importance that extends well beyond the economic skills of individual companies and even industries. It will become one of the pillars of the world in which we are living in 2030.