

IBM Institute for Business Value

Chief Procurement Officer Study

Improving competitive advantage through procurement excellence



IBM Institute for Business Value

IBM Global Business Services, through the IBM Institute for Business Value, develops fact-based strategic insights for senior executives around critical public and private sector issues. This executive report is based on an in-depth study by the Institute's research team. It is part of an ongoing commitment by IBM Global Business Services to provide analysis and viewpoints that help companies realize business value. You may contact the authors or send an e-mail to iibv@us.ibm.com for more information. Additional studies from the IBM Institute for Business Value can be found at ibm.com/iibv

By Steve Peterson, Lori Webber, David Rosselli and Bill Schaefer

To the uninitiated, procurement may seem like a “back office” support function. In fact, it can be a significant contributor to organizational value and a driving force behind gaining competitive advantage. To understand the links between procurement and enterprise performance we conducted one of the largest known surveys of procurement leaders to harvest insights on what actions and decisions are driving positive results. We found that to maximize its impacts on the organization, the procurement function must have a strong set of fundamental capabilities, become an influencer throughout the organization and embrace innovation. The Chief Procurement Officers (CPOs) of organizations that demonstrate these attributes often have a seat at the corporate leadership table – while their underperforming counterparts are relegated to more mundane tactical roles.

Like other strategic functions in the enterprise, procurement’s role continues to evolve. From 2008 to 2012, many companies looked to procurement to help facilitate aggressive cost-cutting targets necessitated by a global economic downturn. As economic realities continue to shift, the procurement function must again adjust. To understand what actions and decisions have led to success in the past, and to derive insights as to what responses might work best in the future, we surveyed 1,128 CPOs from organizations with annual revenue in excess of US\$1 billion.

Through our research, we discovered three key points of differentiation that separate high-performing procurement organizations from the pack:

- Effective delivery of traditional procurement capabilities
- Influence within the enterprise over purchasing and strategic decisions
- Identification of innovative ideas from a diverse range of inputs.

The few procurement organizations that consistently deliver on all three of these important dimensions, approximately 15 percent of the organizations we surveyed, offered unique insights into what works best to move the procurement needle in the right direction. CPOs from these high-performing organizations maintain focus on procurement fundamentals, extend procurement's value through collaboration and develop new capabilities to address emerging procurement challenges.

Leading procurement organizations that combine fundamental capabilities with both influence and innovation unlock possibilities and potential that lagging organizations covet, but are unable to attain. On the other hand, lower-performing organizations tend to focus on creating and improving basic capabilities. They work to build expertise in delivering spend savings and cost reductions to the enterprise, with many struggling to accomplish even this. Many of these organizations crave influence but are left without a voice in corporate strategy discussions.

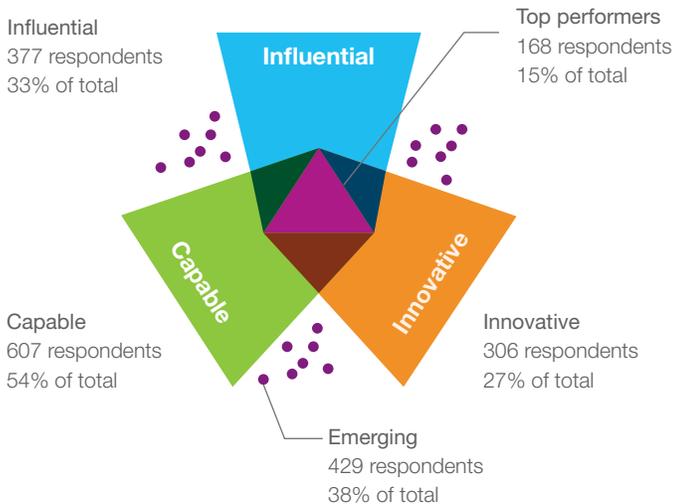
Procurement must collaborate with suppliers and align with the strategic objectives of the enterprise. Leading procurement organizations do this consistently. As they extend their influence, the CPOs that spearhead these organizations are seen as key enablers of corporate strategy.

However, even capable and influential procurement organizations will struggle if they are not also able to innovate. Since the role of procurement is fundamentally tied to the dynamics of the marketplace, leading CPOs embrace this immutable by focusing on the introduction of innovation to retain their competitive edge.

Innovation that makes a difference starts with an intimate knowledge of customer wants and needs. Procurement, in particular, has the opportunity to see these consumer preferences as a result of day-to-day interactions while buying the products and services of their enterprise. The procurement organizations that capitalize on the wealth of information from customers, suppliers and others throughout the supply chain – and which can quickly leverage technology to gain actionable insights from this data – can substantially increase the speed and accuracy with which the company responds to discontinuous change.

Top performing procurement organizations have succeeded in developing and maintaining all three of the important traits. They exhibit strong capabilities, are seen as influential contributors to their business and focus on introducing innovation to drive competitive advantage.

In this report, we will examine the practices of those select few procurement organizations that have developed and mastered the capabilities, influence and innovation that enable them to contribute to the competitive advantage of their enterprises (see Figure 1). We will look at what separates these outperformers from the rank-and-file organizations that fall short in these dimensions. And, finally, we will provide a roadmap that CPOs can follow that will enable them to begin emulating the practices of outperformers.



Source: 2013 Chief Procurement Officer Study, IBM Institute for Business Value.

Figure 1: Top performing procurement organizations have succeeded in combining three important traits – they are capable, influential and innovative.

Study methodology

Working with our research partner, Oxford Economics, the IBM Institute for Business Value surveyed 1,128 global procurement executives from 22 countries in North America, Europe and Asia. Collectively, these executives lead procurement operations in almost every industry, and the companies they serve all have annual revenue in excess of US\$1 billion. The study upon which this report is based is the largest procurement study ever conducted by the IBM Institute for Business Value, and among the largest procurement studies produced anywhere.

After collecting the data from our survey, we analyzed how responses from the world's top-performing procurement organizations differed from those of the remainder of our study population. We defined leading procurement operations as those that believed they had mastered core procurement capabilities, those that said they enjoyed outsized strategic influence, and those that successfully leveraged multiple sources and emerging technologies to bring innovation to the companies they serve. Overall, 168 respondents exhibited all of these attributes in concert. Their responses were examined in detail so that all procurement organizations could benefit from their collective wisdom.

Top performers: Capable, influential and innovative

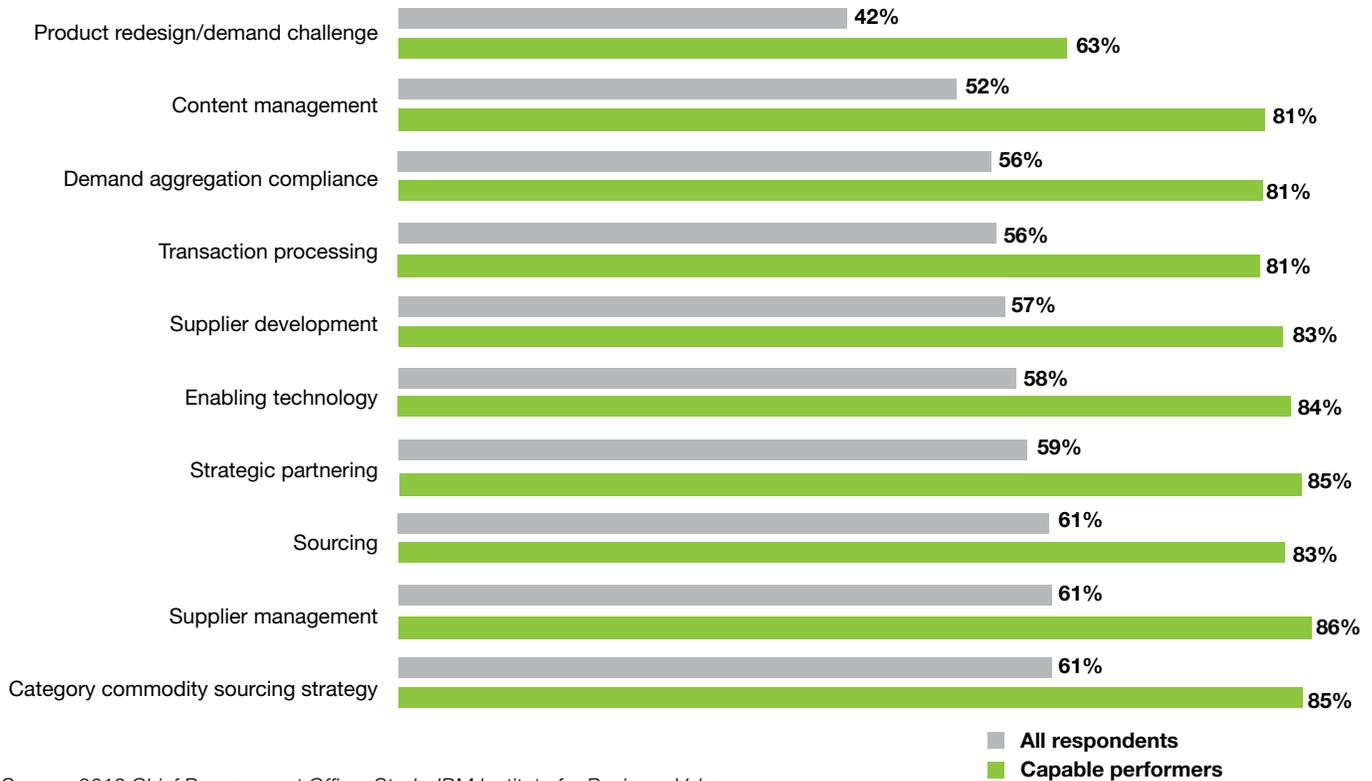
Top-performing procurement organizations excel because they combine three key attributes: they excel at traditional procurement capabilities, they enjoy influence in their organizations and they bring innovation into the enterprise.

Fundamental capabilities form the base of strong procurement performance

The goal for procurement organizations is to dependably deliver value to the companies they serve. To consistently deliver this benefit to the enterprise, the procurement function must, at a minimum, be a master of the fundamentals.

Delivery of spend savings begins with acquiring and developing fundamental competencies such as category sourcing, supplier management and transaction processing. Approximately half of the procurement executives in our study (607) say they are effective or very effective in at least seven of the ten core procurement capabilities (see Figure 2). While excellence in these core capabilities is not enough to achieve exceptional performance, procurement organizations that struggle with the basics often become mired in maintaining the status quo and, as a result, have limited capacity to stretch.

Percent indicating effective or very effective procurement capabilities



Source: 2013 Chief Procurement Officer Study, IBM Institute for Business Value.

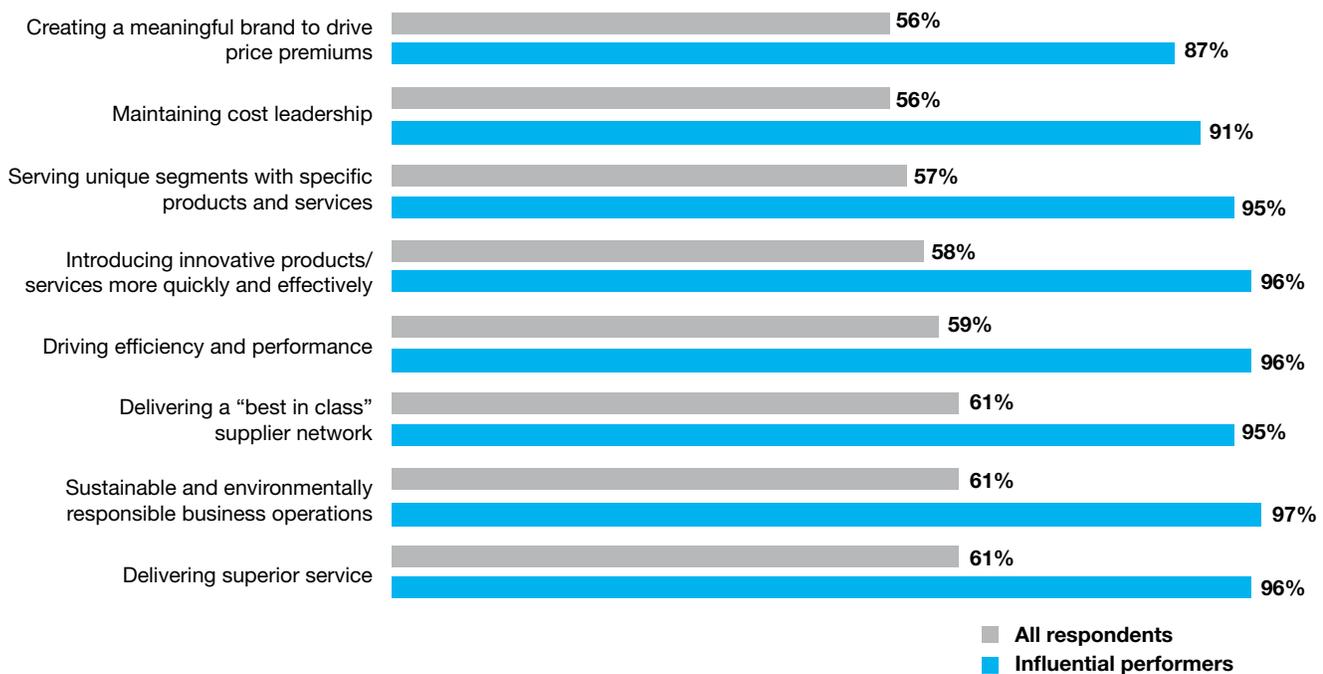
Figure 2: More than half of our respondents indicated they are adept at the core capabilities of procurement.

Top performers are influential in the organizations they serve

Delivering traditional procurement capabilities is important, but the hope of most CPOs is to influence and improve the way the business operates. In this regard, influence is another key element of procurement performance, but fewer procurement organizations seem to excel in this area. Only 33 percent of respondents (377) say they enjoy significant or very significant influence over at least six of eight strategic organizational imperatives, such as delivering customer service, driving efficiency, introducing products and services more quickly and creating meaningful brands to drive price premiums (see Figure 3).

If over 50 percent of respondents have robust procurement capabilities, and only one-third report significant influence, then an obvious disconnect exists in communication; a significant number of companies must be struggling to convey the value they already contribute to the organization. In fact, in face-to-face interviews, a large number of CPOs told us they face challenges in making the organization understand the value procurement provides the organization. In this regard, procurement must not only excel at delivering value, but must also become proficient at promoting the value they deliver throughout the enterprise. One of the CPOs we interviewed from North America emphasized this point: “I have only been in my position for a few years, but I was able to add a lot of value in a short time by simply connecting with executives in a way that put procurement achievements in the spotlight.”

Percent indicating significant or very significant influence over strategic imperatives



Source: 2013 Chief Procurement Officer Study, IBM Institute for Business Value.

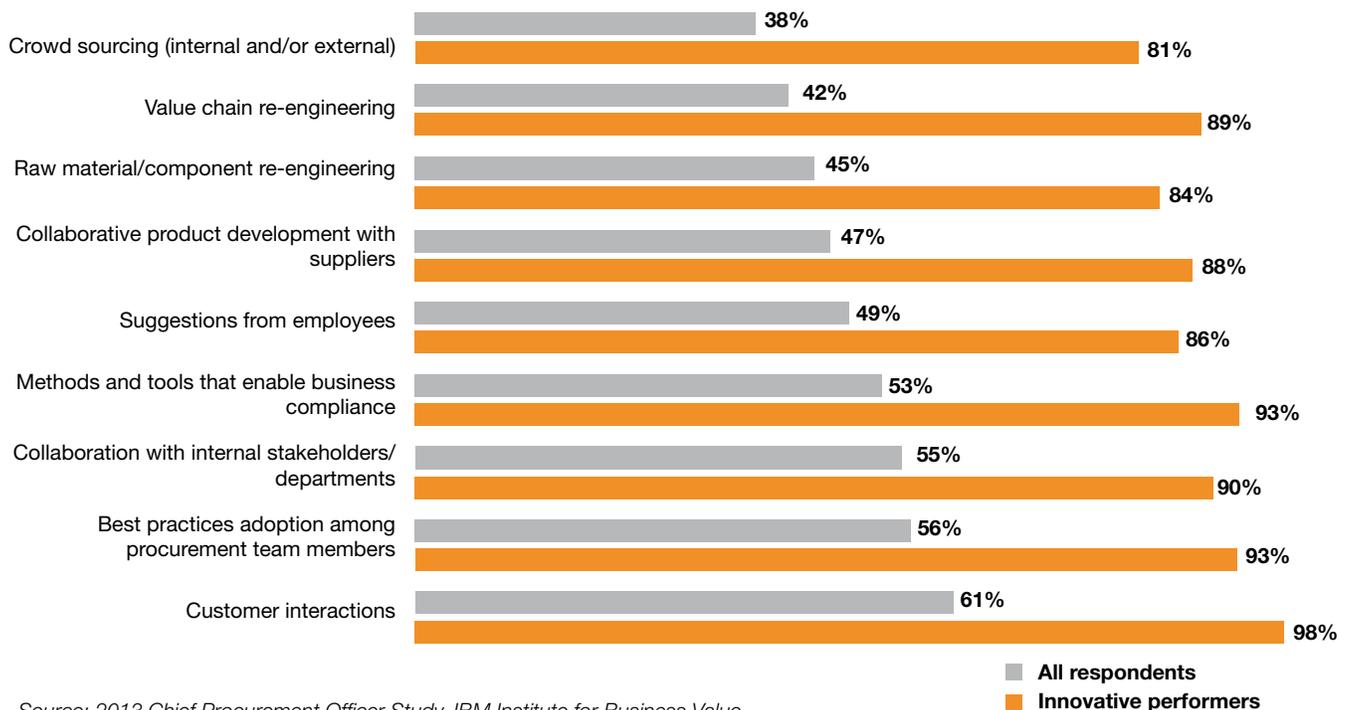
Figure 3: Only a third of procurement executives in our study say they have input into strategic imperatives.

Top performers bring innovative ideas into the organization

While about one half of procurement organizations are effective and a third are influential, even fewer are innovative. Of the 1,128 companies in our study, only 27 percent exhibited characteristics of innovative organizations (see Figure 4). Those that qualified as innovative indicated they look for innovation across a wide range of sources. These organizations said they rated either four or five on a five-point scale on at least five of the nine possible sources of innovation, such as

crowd sourcing, collaborative product development, internal collaboration and customer interactions. As part of being innovative, these respondents also tended to use a wider array of technologies than other respondents (rating a four or five on at least three of the six possible technologies). Technology is a crucial component of innovation for procurement. Increasing automation, for example, enables procurement professions to allocate less time on supporting transactions and more on innovating solutions.

Percent indicating the following sources of innovation are important or very important



Source: 2013 Chief Procurement Officer Study, IBM Institute for Business Value.

Figure 4: Study responses indicate only 27 percent of procurement organizations are innovative; those that innovative are generally more effective in their use of procurement technologies, and are more likely to leverage multiple sources of innovation.

Top performers contribute to competitive advantage by improving profitability

The truly impressive procurement performances came from the 15 percent of organizations (168) in our study that combined capability, influence and innovation. They offer the most fertile ground for identifying the procurement improvements and practices that can lead to success. Going forward, we examine the differences between these procurement top performers and those that have not yet managed to be as capable, influential, or innovative (see Figure 5).

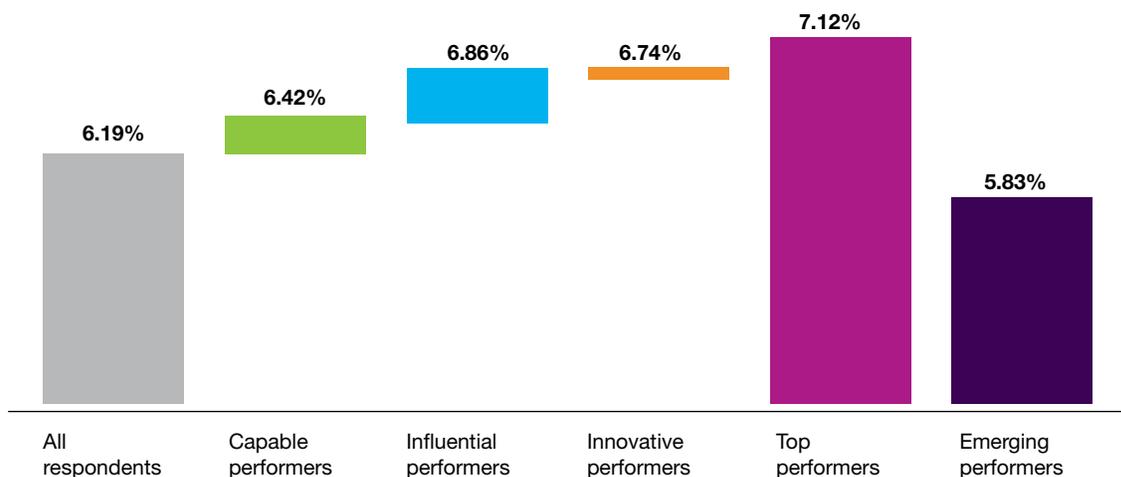
CPOs whose organizations rose to the challenge of the downturn were often provided the opportunity to further contribute to even more strategic corporate issues, such as brand development and new product/service introduction. In part, this insight helps explain the most important link between procurement and competitive advantage in our study: Top-performing procurement organizations reported average enterprise profit margins of 7.12 percent, compared to 6.19 percent for all respondents and just 5.83 percent for low-performing organizations.

Top performers get the basics right... every time

Regardless of the specific mission any individual CPO has carved out for his or her organization, the primary mission is to reduce procurement costs. Advancing this cause depends on a core set of procurement capabilities that top performers achieve through consistent application of the right performance metrics, effective upward communication about performance success and standardization of the processes and procedures that define the function.

Fortunately, traditional procurement capabilities are no secret and are not in dispute among the CPOs we met with in our research. Procurement benchmarks, such as those codified in CAPS Cross-Industry Report of Standard Benchmark Reports, are widely available and well-understood, so the challenge CPOs face is not related to finding which areas of procurement to improve, but in executing to close the gaps.¹

What is your company's profit margin? (average by performance category)

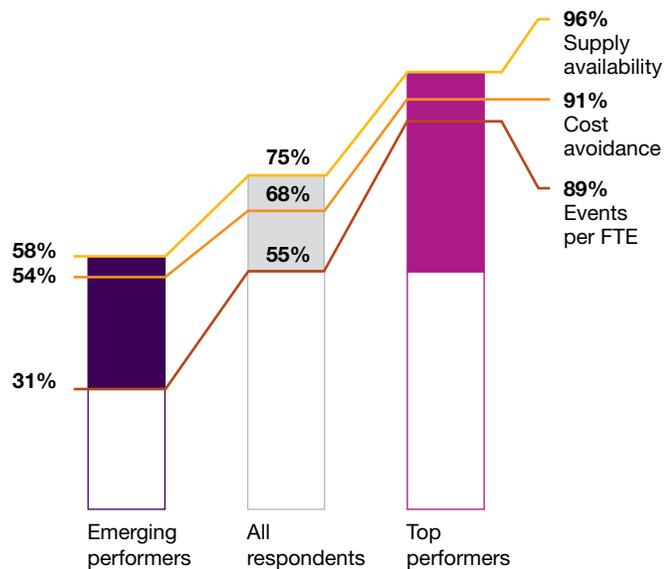


Source: 2013 Chief Procurement Officer Study, IBM Institute for Business Value.

Figure 5: Procurement plays an increasingly important role in the overall success of the organization.

The extensive use of performance metrics to manage their procurement organizations was a distinguishing characteristic of top performers versus low performers. A comparison of selected types of metrics, such as supply availability, cost avoidance (savings) and procurement events per FTE (productivity), revealed that top performers placed a higher emphasis on performance metrics than did low performers (see Figure 6). While a substantial portion of the respondents to our procurement survey use basic supply availability, cost avoidance and procurement events per FTE (75 percent, 68 percent, and 55 percent respectively), only a small number of low-performing procurement organizations use these measures (58 percent, 54 percent, 31 percent, respectively). By contrast, nearly all top performing procurement organizations use them (96 percent, 91 percent, 89 percent, respectively).

Percentage of respondents indicating that their company places high or very high importance the following procurement measures



Source: 2013 Chief Procurement Officer Study, IBM Institute for Business Value.

Figure 6: Percentage of respondents indicating that their company places high or very high importance on the following procurement measures.

Consistent execution of procurement fundamentals, as well as the application of metrics that increase performance, are impactful only when supported by strong and frequent communication with stakeholders and company leadership. CPOs can no longer afford to perform their roles in isolation but must actively engage in communications and interactions across their organization to be influential. Many of the CPOs we interviewed said they struggle, or have done so in the past, with internal communication. To achieve the desired objective for procurement, performance must be accompanied by effective communication.

One simple tool that can improve communication effectiveness, while increasing the CPO's focus on the metrics that matter, are performance dashboards. Many of CPOs we interviewed said the increased use of procurement dashboards in their organization led to improved communication and focus. Perhaps this is why 360-degree views of supplier performance and performance dashboards were the number one solution expected to add value to the enterprise in the next three years (see Figure 7).

Procurement automation, along with the methods, standards, and tools that support their use, often achieve the levels of efficiency that are implied by procurement benchmarks and best practices. The gap between outperformers and others, however, is wide in how technologies are used to support activities ranging from sourcing/RFX automations to spend analysis solutions. More than 80 percent of the top performers in our study believe their procurement organizations are "above average" or "excellent" at the application of procurement technologies, compared to less than 50 percent of respondents in our full sample (see Figure 8).

Of course, solid performance on the metrics that matter can only be advanced by automation when the right people are in place within the procurement organization. Specialized skills for critical roles, such as strategic sourcing and category management, may be lacking internally and difficult to obtain through hiring. Utilizing external sources or providers can help a CPO objectively identify what needs to be improved and offer advice about how to implement the necessary improvements.

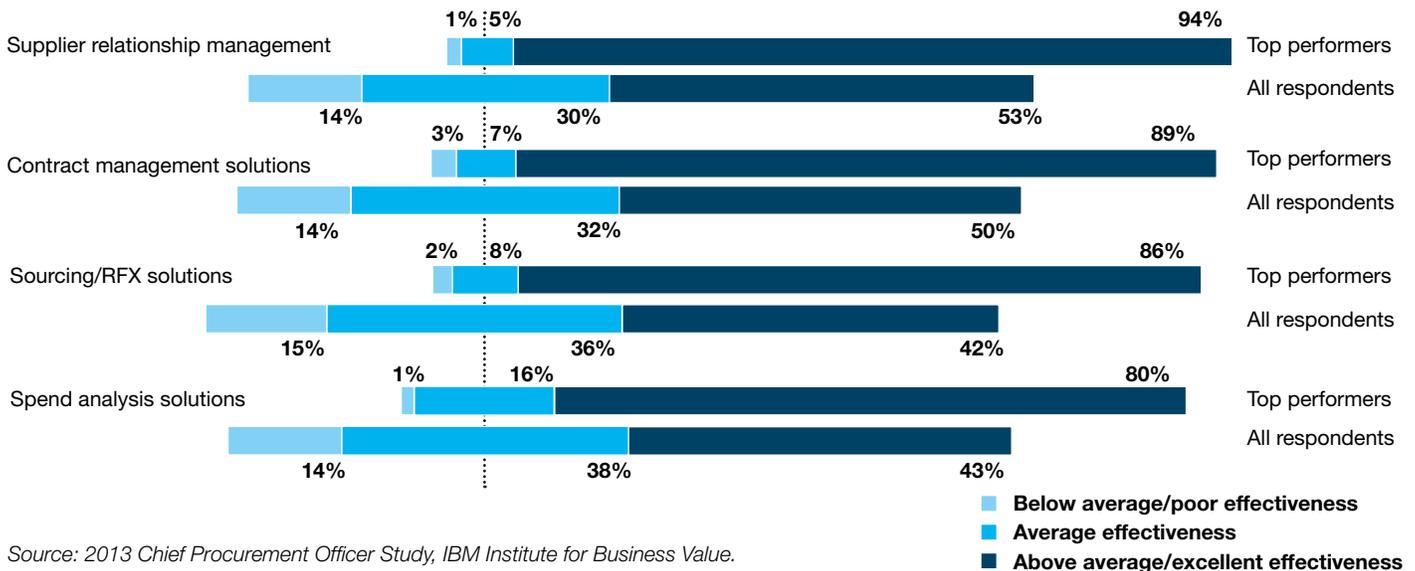
Which solutions and/or activities add the most value to your enterprise



Source: 2013 Chief Procurement Officer Study, IBM Institute for Business Value.

Figure 7: Sources of value are expected to change significantly over the next three years.

Effectiveness of procurement technologies by performance category



Source: 2013 Chief Procurement Officer Study, IBM Institute for Business Value.

Figure 8: Top performers are, by a considerable margin, more adept than underperformers is using procurement technologies.

Effective collaboration helps top performers thrive

Top-performing procurement organizations recognize the value of collaboration. Compared to their lower-performing peers, these top performers excel at both internal collaboration – collaboration between employees – and external collaboration – collaboration with customers, partners and suppliers.

Supplier collaboration helps top performers bring the outside in

Owing to its unique position as a bridge between the enterprise and the outside world, procurement can often deepen its influence by leveraging its connections beyond firm boundaries. Top-performing procurement organizations exhibit a greater tendency to respond well to product redesign or demand challenges (73 percent of top performers say they are effective or very effective at this skill, compared to only 16 percent of low-performers). This suggests that top performers are more tuned-in to their supplier communities than their low-performing counterparts.

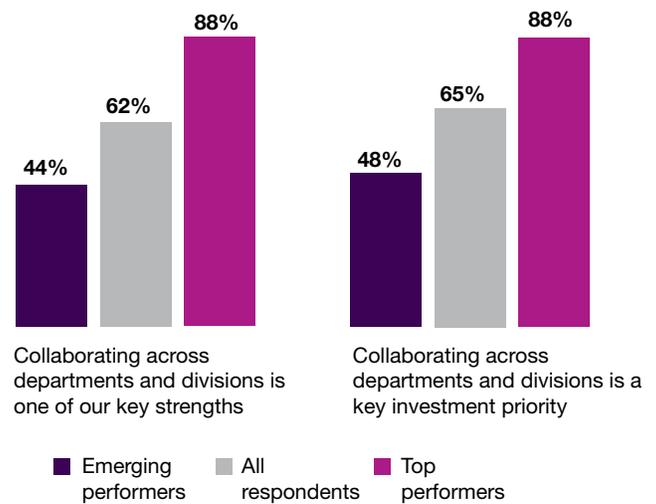
Effective supplier collaboration improves a company’s ability to respond to its customers because it leads to increased value and insights from the supplier relationship. On average, top performers direct 38 percent more of their annual spend through strategic alliances than low performers. These alliances are one avenue through which CPOs collaborate with suppliers.

Supplier collaboration, in the view of several survey respondents, is directly linked to improved responsiveness, as well as market awareness. This is no surprise because suppliers often work across many companies and industries, and are, therefore, more closely in touch with customer preferences. By improving their relationships with these well-connected suppliers, leading CPOs effectively extend their reach and deepen their insights into markets and, indirectly, into the needs of customers.

Top performers also use internal collaboration to effectively connect to the enterprise

Top performers are also more likely to leverage internal collaboration than average or low performers (see Figure 9). In fact, more than 80 percent of top performers say that collaboration across departments and divisions is both a key strength and an investment priority. Less than half the low performers provided the same response.

To what extent do you agree with the following statements?



Source: 2013 Chief Procurement Officer Study, IBM Institute for Business Value.

Figure 9: Top performers collaborate more inside the organization than low performers.

The benefits of collaborating well within the enterprise are numerous. Not only will procurement perform its core mission better when it understands the needs of its internal customers, but it will also be positioned to spot untapped sources of value through improved connections with internal communities. By collaborating with the new product development team, for example, procurement might identify a need to source new and innovative components from suppliers. While working with the marketing department to bring down category spend, procurement might also find ways to improve demand forecasts and thereby more affordably secure needed supplies for the entire enterprise. Finally, by collaborating with IT, procurement can help get the right systems in place to improve decision effectiveness and efficiency across the enterprise. Clearly, procurement can improve corporate performance in unique and powerful ways when it is plugged into a wide array of internal communities.

Top performers use collaboration to access innovative ideas

Business executives are frequently chastened by academia and the business media to “get closer to customers.” Few corporate functions are as well-positioned to deliver against this objective as procurement. Procurement, by its very nature, forms the bridge between the market and the company, and CPOs that leverage this position bring significantly more value to their companies than those who have not yet capitalized on this reality.

Top-performing procurement organizations know that customers, be they end-consumers or internal departments and divisions, are a powerful source of insight. They are significantly more likely than others to see customer interactions, collaboration with internal stakeholders and departments, collaborative development with suppliers and crowd-sourcing as important sources of innovation. CPOs that embrace this truth, for example, are more likely to have strong connections and relationships with manufacturing, research and development and marketing.

“Sourcing is in a unique position. We have one foot inside of the company working with our internal partners, and one foot outside of the company working with our supply partners. We have to step up our game in bringing ideas and market intelligence from the outside, connecting throughout the company, all of the way back through R&D and innovation. By facilitating this increased collaboration and innovation we impact not only costs, but also top line revenue generation.”

Laurie K. Stewart

Chief Procurement Officer

Air Products and Chemicals, Inc.

CPOs across all performance categories tend to believe that they extract more value for the enterprise from solutions and activities that are focused on the internal organization. In the next three years, however, they expect a shift to more externally focused solutions. Systems and process controls that increase transaction compliance are currently at the top of today’s enterprise value ranking (out of eight possible solutions and/or activities).

However, in the next three years, this same solution is expected to fall to precipitously, to seventh position. Similarly, CPOs see central content repositories, another internally focused solution, as the third most significant contributor to enterprise value today, but they expect it to be sixth in just three years.

Top performers develop new capabilities for a new world

Top-performing procurement organizations achieve results by staying ahead of change. For example, leading procurement organizations embraced fundamentals like automation and collaboration before they were common. Similarly, top performers are currently at the leading edge of risk management, procurement analytics and talent management, and we expect the focus on these key three areas will continue to confer advantage to the CPOs who excel in these areas.

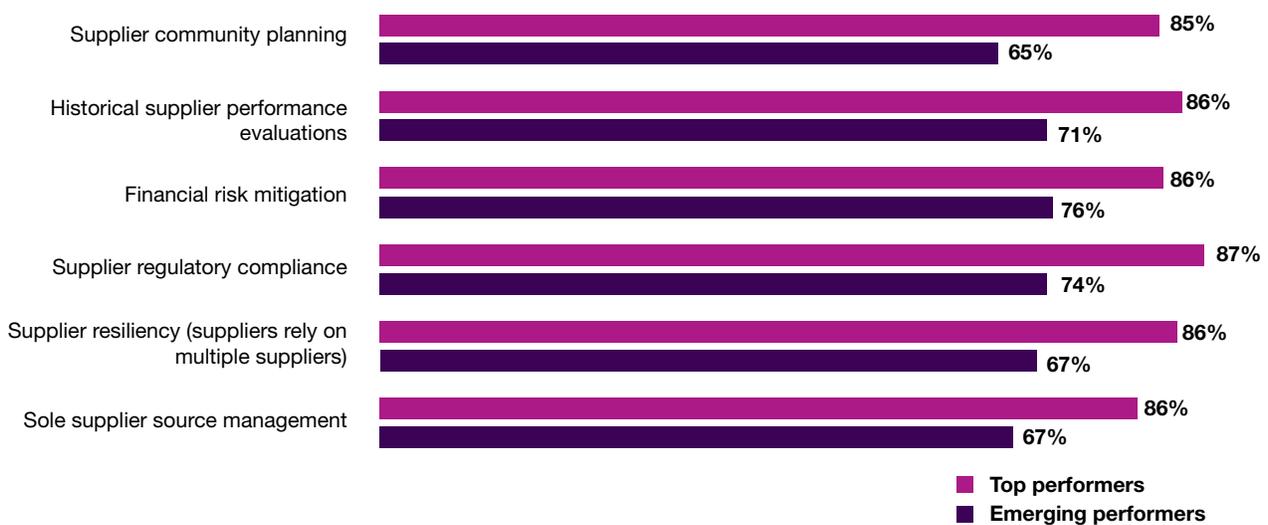
Top performers understand the value of risk management

An important new priority for procurement organizations is the increased focus on risk management with their supply base. With the growth in awareness of increased risk associated with global supply chains, CPOs from both top-performing and low-performing organizations expect an enhanced focus on

risk management over the next three years. Exceptional risk-management capabilities often drive cost efficiencies and enhance competitive advantage for the firms they serve (see Figure 10).² It is little wonder, then, that risk management is also top of mind for so many other senior executives, ranking as one of the top five concerns in all of our CEO and CFO studies since 2010.

Procurement is uniquely positioned to identify and adjust for enterprise risk. The CPO with strong connections to corporate suppliers can become aware of quality issues in the supply chain long before the issues find their way into the distribution system. Similarly, procurement can also find and rectify vulnerabilities related to both supplier concentration and the financial strength of business partners. Indeed, in many ways, some of the most critical risk management opportunities cannot be influenced or improved without the support of the procurement function.

To what extent will your company focus on procurement risk management objectives in the next three years?



Source: 2013 Chief Procurement Officer Study, IBM Institute for Business Value.

Figure 10: Most procurement organizations recognize the potential value of risk management.

Procurement analytics confers clear advantages to top performers

Procurement top performers also tend to see real value in the application of procurement analytics. Top-performing procurement organizations were 31 percent more likely to indicate that they currently excel at procurement analytics than their lower performing peers.

Top performers bring analytics to bear in unique and powerful ways. Some CPOs dedicate the analytic prowess of their organization to the systematic identification of savings opportunities within a category or department. Others have found success by using analytics to optimize demand forecasts that enable them to secure more favorable long-term contract terms with suppliers. Of course, the true power of procurement analytics is only just being discovered, but CPOs from top-performing procurement organizations recognize that it is essential to continue to perfect this core skill.

Interestingly, we also found that procurement organizations across all levels of performance have gaps in their procurement analytic capabilities, as evidenced by their recognition that procurement analytics has significant room for improvement. These same CPOs also admit that data quality issues often interfere with their ability to advance their procurement analytics agenda. In other words, almost all CPOs, even those with relatively successful procurement analytic programs, know that they can get more from this emerging capability (see Figure 11).

With the right analytic tools, the right data, and of course procurement experts who know how to identify the deep associations and implications hidden in complex data, procurement analytics can substantially improve procurement decisions. One company we spoke to in our one-on-one interviews said that analytics had become a “core competence and foundational skill” for the employees in his organization.

To what extent do you agree or disagree with the following statement?



Source: 2013 Chief Procurement Officer Study, IBM Institute for Business Value.

Figure 11: Top performers derive value from procurement analytics, but they also understand the challenges and potential for improving this capability in the future.

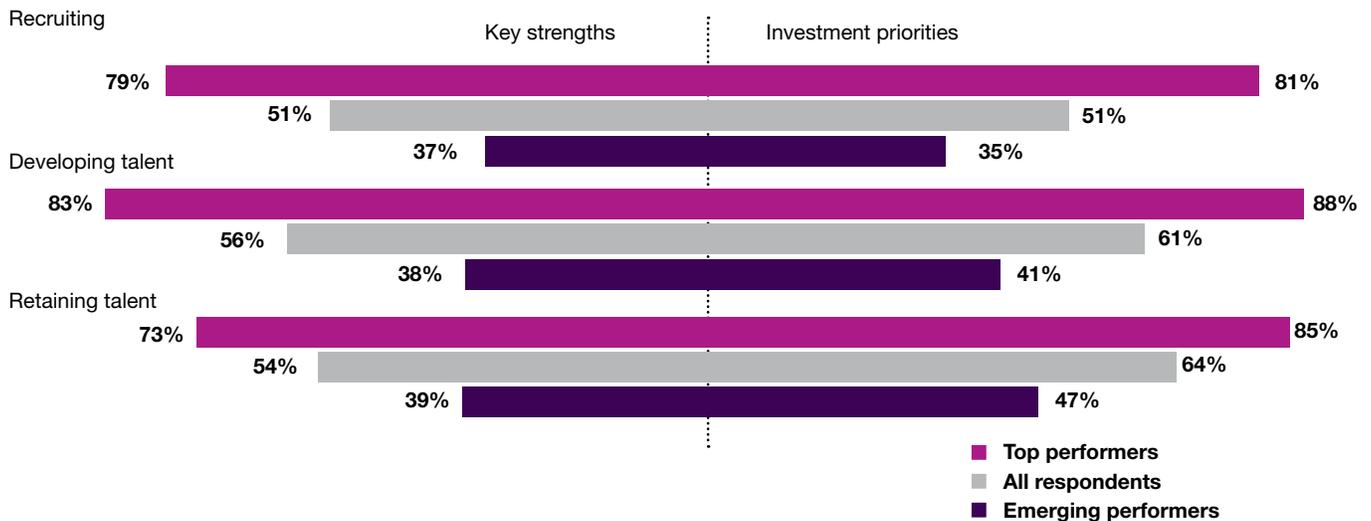
“Developing insights and turning that knowledge into innovative solutions is critical to our business organization successes.”

Mike Berry
 Vice President
 Global Sourcing and Chief Procurement Officer
 Eastman Chemical Company

Above all, top performers know the value of great people

Above all, CPOs of leading procurement organizations know that success depends on getting skills and expertise needed to execute the mission they have been given. This, in part, explains why top-performing procurement organizations are so much better than their lower-performing peers across all measures of talent management. By percent, twice as many top performers than low performers view recruiting and talent development retention as a key strength. What is more, top performers often extend these human capital advantages because they are equally aggressive in their investment plans for retention, recruiting and talent development (see Figure 12).

Is human capital a strength and/or priority in your procurement organization?



Source: 2013 Chief Procurement Officer Study, IBM Institute for Business Value.

Figure 12: Top performers focus more than others on recruiting, talent development and retention.

In several one-on-one interviews, the CPOs we spoke to stressed the importance of talent. One CPO initiated a recruiting program that focuses on attracting top graduates from the most elite institutions in the world. As process standardization, procurement automation and corporate compliance increased, this CPO found that higher-order skills were needed from his staff to meet the needs of an increasingly demanding business. Top talent has become an essential ingredient of procurement success at this company, and the intense focus on talent among procurement top performers suggests that this trend may well continue.

Accelerating the journey to competitive advantage

Our research into the procurement function, and our close analysis of most effective, influential and innovative procurement organizations, has shown that success depends on getting the fundamentals right, collaborating effectively within and beyond the enterprise and developing new capabilities for the future. Across each of the central recommendations contained in our study, a more detailed set of sub-recommendations have been developed for procurement organizations across all levels of performance.

For companies just starting the journey to improved procurement performance, the logical first step is to ensure that the organization is focusing on the right metrics. Measuring cost savings, spend reduction and events per FTE are simple-but-important ways to help the organization start building fundamental capabilities. Even for these relatively low performers, collaboration is key. It helps procurement get in touch with the

needs of its customers, and it can open new possibilities for adding value to the enterprise. Finally, low-performing procurement organization must prepare for the future by bringing risk management into the procurement portfolio because risk management will become an essential procurement strength in the future.

Procurement organizations that currently achieve average performance have probably already begun to master the procurement basics. CPOs in charge of organizations in this category should not only hone their performance on fundamentals through the application of benchmarks and best practice, but they should also focus on communicating the value procurement adds to the enterprise throughout the halls of the executive suite. Automation can be leveraged by CPOs in this category to more systematically connect with partners and suppliers, which gives procurement the opportunity to improve its people by focusing on skill development, recruiting and retention.

Of course, procurement organizations that are already at the top of their game cannot afford to stand pat if they wish to maintain their leadership position. Procurement organizations in this category can build on their strengths by automating and applying best practices to parts of their operation that are not standardized today. They should continue to harvest innovative ideas from a wide range of sources, especially those outside the bounds of the enterprise. Finally, the top performers should make ample use of procurement analytics to trim costs and augment value.

	Emerging performers	Average performers	Top performers
Maintain focus on procurement fundamentals	Focus on the metrics that move the procurement needle	Influence is earned with solid performance and effective communication... so get good at both	Leverage best practices and technologies to increase procurement standardization
Extend procurement's value with deep collaboration	Collaborate to increase procurement's understanding of internal and external customers	Harness the power of automation to more tightly connect procurement to partners and suppliers	Recognize that innovation comes from a diverse range of sources
Develop new capabilities for a new world	Make risk management an essential aspect of the procurement portfolio	Optimize procurement talent to meet the demands of the procurement world of tomorrow	Leverage data and analytics to improve efficiency and effectiveness

To steer the ship of corporate procurement in a direction that will drive competitive advantage, CPOs should ask and answer a few challenging questions:

- What is the return on investment (ROI) that procurement is delivering to the business?
- How well are we performing versus objective benchmarks and best practices?
- Is the full value of procurement effectively communicated to stakeholders?
- How is technology being used to drive greater efficiency and effectiveness?
- Are there business processes that might be better handled by a third party so our organization can focus on strategic activities?
- Is procurement collaboration both simple and standardized across the company?
- Are internal and external customers being tapped as sources of innovation?

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