



WHAT STRATEGIC PROCUREMENT CAN DO FOR UTILITIES

By Harish Hemmige, Raphaël Desi, Justin Dean, and Buzz Maslov

WHEN DEPLOYED STRATEGICALLY, THE procurement function can be a powerful source of competitive advantage for utilities. Potential benefits include substantial cost savings, stronger and more productive ties with suppliers, and shared, innovative solutions to problems. Yet few utilities unlock the procurement function's full capabilities. Instead, the function remains confined to its traditional, purely tactical role—executing purchasing at the behest of the business and ensuring that suppliers comply with company guidelines. Unfortunately, this narrow approach to procurement comes at a sizable opportunity cost to utilities at a time of unprecedented financial and operational strain.

Empowering the procurement function to participate in high-level business strategy and incorporating it seamlessly into the daily operations of a utility can be quite challenging. But the rewards of doing so can repay the cost of the effort many times over. BCG has designed a comprehensive and effective approach to getting there—one that spans strategy, organizational

design, people and skills, metrics, and other key considerations. It is battle-tested, readily customizable to individual businesses, and designed for minimally disruptive implementation. It might be right for your organization.

A Potentially Powerful Lever

In recent years, utilities have faced mounting pressure to replace their aging infrastructure (most coal-fired power plants are now more than 30 years old, for example) and expand their grid functionality. Simultaneously, they have had to contend with depressed wholesale power prices and, in the US, recent changes in corporate taxation that have led to reduced cash flows.¹

Against this backdrop, utilities have been focusing on cost reduction while avoiding layoffs. In short, they have trained their sights on areas such as procurement in pursuit of cost-cutting opportunities.

Procurement can indeed be fertile ground for identifying and realizing cost savings in

organizations that give the procurement function a strategic role and sufficient latitude to work effectively. When the procurement function is enabled in this way, we have seen step-change reductions in supplier costs, with savings that reach as high as 10% to 20%—without any sacrifice in the safety or quality of delivered goods or services. Moreover, the utilities have often begun realizing these savings immediately, with cash accruing during the same year as implementation.

Many of the organizational changes needed to effectively empower the procurement function can also foster greater efficiency across the function’s suite of day-to-day activities. This, in turn, can free up even more time for the function to focus on creating more-robust sourcing strategies. So the delivery of cost savings becomes an ongoing focus and a repeatable event.

Few utilities currently enable this sort of contribution from the procurement function. Instead, most of them limit the function to tactical execution of the business’s day-to-day sourcing needs. Unfortunately, this channeled focus on immediate concerns prevents the procurement function’s leadership from thinking strategically about how it might approach the task of procurement—and the utility’s relationships with suppliers—differently and to greater advantage.

The procurement function at most utilities is thus a largely untapped resource. Although it executes a vital task, it could be doing much more for the business. The question is, how can utilities enable the necessary transformation of the function and of the broader organization?

Getting There

BCG recommends pursuing a transformation effort that focuses on five areas: role definition and strategy formulation; organizational design; people and skills; value delivery; and tools, metrics, and systems. (See Exhibit 1.)

Role Definition and Strategy Formulation.

In order for the procurement function to deliver its full potential value, a utility must ensure that it has a meaningful seat at the table in business decisions and planning. The function’s ambit of influence must extend over the vast majority of company spending. And the utility must formally incorporate the function’s involvement and positioning in the company’s overall business operations.

In formulating its strategy for maximizing its contribution to the organization, the procurement function should work closely with business stakeholders to fully understand their requirements and to participate from an early stage in the utility’s decision-

EXHIBIT 1 | Key Dimensions of Procurement Transformation



ROLE DEFINITION AND STRATEGY FORMULATION



ORGANIZATIONAL DESIGN



PEOPLE AND SKILLS



VALUE DELIVERY



TOOLS, METRICS, AND SYSTEMS

Source: BCG analysis.

making processes, thereby ensuring proper alignment of the company's sourcing and business strategies. At one utility we worked with, early and active involvement of the procurement function in the capital planning process led to aggregated sourcing of multiple years' worth of transformers and other capital equipment—rather than piecemeal sourcing of that equipment through a series of smaller, one-off deals—resulting in a savings of 15%.

Organizational Design. The procurement function at most utilities lacks any clear organizational distinction between tactical purchasing and higher-value-added strategic sourcing. Staff and mandates are blended, resulting in misallocated resources. In contrast, maintaining a clear distinction between the two types of roles allows the procurement function to dedicate its best resources to the most critical, value-unlocking tasks. Separating tactical from strategic roles organizationally also puts the procurement function in a better position to effectively leverage technology and automation.

At one utility we worked with, the procurement team transformed its organizational structure into one based on newly defined strategic roles designed to better leverage scale and meet the utility's unique business needs. The new structure included a supplier relationship management group, which focused on building better partnerships with key suppliers; a supplier development group, which worked to find suitable suppliers in low-cost countries and regions; an organizational category group, which holistically managed strategic procurement for business categories spanning the entire company; and a shared-services function, which focused on operational sourcing and transactional purchasing.

This structure enabled the procurement function to leverage scale and to coordinate its efforts with those of the business more effectively, translating into far better results than the function had previously achieved. It also allowed the function to devote sufficient time and skill to strategic activities.

People and Skills. To deliver maximum value, the procurement function must have the right staff. Attracting the necessary talent involves defining a career path for top performers that allows them to succeed and gain recognition for their efforts. Over the long term, the function must build and maintain a reputation as a good career choice for motivated, strong-performing individuals.

Appropriate training is also critical. Procurement teams must be versed in such levers as best-country sourcing, value engineering, and supplier collaboration if they are to exploit them fully. We helped one utility's procurement function create a strong platform for developing new suppliers in low-cost countries. This entailed building a framework to determine the highest-potential countries for each business category, designing a playbook to identify and select providers within each, and establishing cross-functional teams with business stakeholders to ensure clear communication and understanding of the potential business case for using these providers. Training played a major role in each of these efforts. Once the program was operational, the utility routinely saw savings of 8% to 10%.

Training in various aspects of procurement should be ongoing, supplemented by career development sessions, to ensure that staff members remain at or near the cutting edge in knowledge and skill.

A final consideration relates to metrics and KPIs. Using the right ones will ensure that people on staff stay motivated and focused on delivering value for the company.

Value Delivery. The procurement function can deliver value in different ways. The most obvious is traditional cost savings. Here, the function must be willing and empowered to challenge entrenched procurement practices and supplier relationships across the company. One procurement function we worked with had been assured by a particular business unit that a longstanding incumbent supplier's pricing for craft labor was as low as it could go.

But after the function obtained greater pricing transparency from the incumbent regarding its cost structures and subjected the incumbent to a detailed request-for-proposal (RFP) process—one in which other players came in much cheaper—the incumbent ultimately reduced its pricing by 10% by removing costs that it had baked into other areas.

Organizations can also create value by rethinking how they manage their supplier relationships, especially with an eye toward fostering joint innovation. We helped one procurement function work with its utility's sole-source provider of waste management services to identify new ways the companies could work together to leverage nascent technologies. In the course of this collaboration, the organizations struck a longer-term agreement that ultimately lowered costs for both companies.

The procurement function has other value-delivery levers at its disposal as well, such as working in close partnership with the business to ensure that the risk and quality parameters attached to sourcing deals are accurate and realistic. Misalignment in this area puts the utility at risk of spending more than it needs to—or, conversely, not spending enough—in a given situation.

Tools, Metrics, and Systems. In order to drive meaningful, sustainable change, the procurement function must have the right tools at hand, including templates and forms, e-sourcing platforms, and contract management systems. It must also confirm that it has the right metrics in place and is properly tracking them. Such metrics should hold all parties accountable and should ensure that any delivered savings will actually reach the bottom line.

Procurement functions should consider leveraging rapidly evolving solutions that use big data and analytics to create additional savings and a more efficient supply chain. A growing number of procurement functions use data visualization and optimization tools to access real-time pricing data and gain greater inventory visibility. Through such tools, a utility's supply-chain

professionals may gain a fuller awareness of inventory across the entire organization in order to transfer needed equipment, for example, or better understand workflow patterns and make necessary adjustments to the warehousing footprint. Through big data and analytics, these scenarios are becoming a reality, and procurement functions should aim to stay at the front of the curve. (In a subsequent article, we will discuss in depth the potential application of digitization in utilities' procurement.)

A Holistic Approach to Implementation

The procurement function can tackle each of these five facets individually. Our preference, though, is to address all or several of them together (depending on an organization's starting point), given their interdependencies and potential synergies. In our experience, this approach typically leads more quickly to the realization of more-sustainable results.

An example of the holistic approach in practice is our work with a utility that sought a broad, large-scale transformation of its procurement function. At the outset, the function performed the relatively narrow role of tactical sourcing that it plays in most utilities. The function was not a strategic partner to the business.

Working in close partnership with the organization, we rebuilt the procurement function, focusing on three key tasks:

- **Implement structural changes in the function's operating model to better support value delivery.** This effort included redefining roles and responsibilities, separating strategic work from tactical work, and increasing the function's level of engagement with its business customers.
- **Develop new capabilities within the core strategic procurement function.** The capabilities in question ranged from best-cost country sourcing to cost modeling. The goal was to enable a step change in value delivery.

EXHIBIT 2 | First Steps in Procurement Transformation



Recognize the competitive advantage that a strategically deployed procurement function can deliver



Identify critical gaps and weak points in the procurement function's capabilities



Ensure leadership buy-in for a comprehensive transformation effort

Source: BCG analysis.

- **Embed the new capabilities and begin to deliver value.** The procurement function accomplished this task through competitive RFPs, negotiations with suppliers and potential suppliers, and collaboration with suppliers in a quest for potential shared solutions.
- **Ensure leadership buy-in for a comprehensive transformation effort.** Change is not going to happen unless leaders support it and demonstrate their commitment to it.

Two years after beginning its transformation, the procurement function is on track to reach its target goal of a 15% savings. Further, the function has improved its focus on strategic activities and has stronger relationships with its business stakeholders.

TRANSFORMING THE PROCUREMENT function is a major undertaking. Done right, however, it can have a substantial material impact on a utility's performance. If you are interested in hearing more about our approach, our experience in this realm, and how we might work with your organization, please contact us.

Taking the First Steps

To ensure an effective start on this journey and to contribute to the journey's ultimate success, a utility needs to do three things, as indicated in Exhibit 2:

- **Recognize the competitive advantage that a strategically deployed procurement function can deliver.** A procurement function that is limited to tactical execution will not unlock much value. One that is sufficiently empowered and seen as a strategic partner to the business will.
- **Identify critical gaps and weak points in the procurement function's capabilities.** BCG's Procurement Excellence Monitor takes a deep dive into the five dimensions discussed earlier and can help the function pinpoint where to look and what to treat as most important.

NOTE

1. See "[Moody's downgrades U.S. regulated utility sector as cash flow is reduced by tax cuts](#)," Energize Weekly, June 27, 2018.

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