Competitive Advantage through Strategic Global Sourcing

Manfred Meffert – IBM Global Procurement

Porto, April 13, 2010
Competitive Advantage through Strategic Global Sourcing

- Building strong Global Procurement Capabilities through Procurement transformation

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

- Focus on innovation to leverage procurement capability and synergy
The collective insights from 400 Supply Chain Executives identify 5 major challenges that comprise the CSCO agenda

<table>
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<tr>
<th>COST CONTAINMENT</th>
<th>SUPPLY CHAIN VISIBILITY</th>
<th>RISK MANAGEMENT</th>
<th>INCREASING CUSTOMER DEMANDS</th>
<th>GLOBALIZATION</th>
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<td>Fighting integral costs as such as might be futile, but being flexible can identify cost savings elsewhere</td>
<td>Supply chain visibility is inhibited by a lack of capabilities and an unwillingness to collaborate.</td>
<td>Process, data, &amp; technology are identified as the roadblocks to good risk management, yet they are the key enablers.</td>
<td>Customers have increased demand for more precise synchronization of supply and demand.</td>
<td>Lead times, delivery, and quality are top challenges, but overall globalization has been a positive boon for all.</td>
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Based on responses of “to a very great extent” and “to a significant extent”
IBM Company Profile – 4Q09

IBM delivers on-demand solutions through the following business segments:

- Global Technology Services
- Global Business Services
- Hardware
- Software
- Global Financing

4Q09 Financials from Continuing Operations:

- Revenue: $27.2 billion
- Net Income: $4.8 billion
- Gross Profit Margin: 48.3%
- Earnings Per Share: $3.59
- Number of employees: 386,558
- Number of registered stockholders: 585,572

Over time, the nature of our business operations has shifted from a hardware oriented business to what is now a services-led business.

A Balanced Mix of Hardware, Software and Services ($= Billions USD)

<table>
<thead>
<tr>
<th>Segment</th>
<th>Revenue (Billions USD)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Technology Services</td>
<td>$10.1</td>
<td>37.1%</td>
</tr>
<tr>
<td>Global Business Services</td>
<td>$4.6</td>
<td>16.9%</td>
</tr>
<tr>
<td>Hardware</td>
<td>$5.3</td>
<td>19.5%</td>
</tr>
<tr>
<td>Software</td>
<td>$6.6</td>
<td>24.2%</td>
</tr>
<tr>
<td>Global Financing</td>
<td>$0.6</td>
<td>2.3%</td>
</tr>
<tr>
<td>Total IBM Revenue*</td>
<td>$27.2</td>
<td>100%</td>
</tr>
</tbody>
</table>

EPS of $10.1 in 2009
Why are companies moving to a global integration model?

20th century

International exporting

Multinational

Country silos

Global

Full integration

“Global Integration is about…doing the right work in the right places at the right cost. It’s not simply labor arbitrage. It’s not simply lower-cost skills. You must have the capabilities in the right places … processes and discipline to integrate the skills and systems and make them work for the client…” - Sam Palmisano, 2006
Worldwide IBM Hardware Manufacturing Locations

Low Cost Geo's

- Rochester
- San Jose
- Guadalajara
- Dublin
- Poughkeepsie
- Montpellier
- Vac
- Fujisawa
- ITP / IIPC
- Pondicherry
- Singapore
- Low Cost Geo's

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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>
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<tr>
<th>Organization</th>
<th>People</th>
</tr>
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<tr>
<td>• Decentralized</td>
<td>• Generalists</td>
</tr>
<tr>
<td>• End user dissatisfaction</td>
<td>(lacked sourcing expertise)</td>
</tr>
<tr>
<td>• Maverick buying</td>
<td>• Tactical focus</td>
</tr>
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<table>
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<tr>
<th>Process</th>
<th>Technology</th>
</tr>
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<tr>
<td>• Inconsistent</td>
<td>• Patchwork of legacy systems</td>
</tr>
<tr>
<td>• Paper intensive</td>
<td>• Lacking basic spend info</td>
</tr>
<tr>
<td>• Lacking leverage</td>
<td></td>
</tr>
</tbody>
</table>
IBM’s Procurement environment in the early 1990’s left a lot to be desired

We were faced with some serious gaps in our procurement performance

<table>
<thead>
<tr>
<th>Organization</th>
<th>People</th>
<th>Business Metrics</th>
<th>Early 1990’s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decentralized</td>
<td>Generalists</td>
<td>Savings / Competitiveness</td>
<td>Unknown</td>
</tr>
<tr>
<td>End-user dissatisfaction</td>
<td>(lacked sourcing expertise)</td>
<td>Maverick Buying</td>
<td>30 - 40%</td>
</tr>
<tr>
<td>Maverick buying</td>
<td>Tactical focus</td>
<td>Satisfactory Audits</td>
<td>55%</td>
</tr>
<tr>
<td>Process</td>
<td>Technology</td>
<td>Client Satisfaction</td>
<td>40%</td>
</tr>
<tr>
<td>Inconsistent</td>
<td>Patchwork of legacy systems</td>
<td>P.O. Processing Cycle-Time</td>
<td>30 days</td>
</tr>
<tr>
<td>Paper intensive</td>
<td>Lacking basic spend information</td>
<td>Contract Cycle-Time Length</td>
<td>6 - 12 months</td>
</tr>
<tr>
<td>Lacking leverage</td>
<td></td>
<td></td>
<td>40 (+) pages</td>
</tr>
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</table>
Procurement Transformation
Starting in the early 1990’s, Procurement began a journey that continues today


Establish Foundation Enterprise Transformation e-Business Integrated Supply Chain GIE

Established organization and governance and initiated Sourcing Councils
Developed common processes and implemented enabling technologies around the world
Established true external electronic collaboration with suppliers and partners

**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 partnerships 10 strategic 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
Procurement Global Organizational Model

- All procurement employees report into one financial division
- Presence in over 80 countries, in hundreds of discrete locations
- Includes over 500 Procurement Engineers
- Provides global focus, buy-in to organization strategy and goal congruence
- Provide procurement services for both IBM internal and commercial clients

Spend: $11B
Procurement Best Practices (7)
We will look continuously at our processes and compare against selected best practices across the entire source-to-pay process to gain process efficiency.

1. Organizational Transformation

2. Strategic Sourcing Councils

3. Procurement Operations / Compliance

4. Procurement A/P Linkage

5. Financial Interlock

6. Technology Platform

7. Skill Development

= critical success factors

Examples:
- IT Equipment
- Services
- Consumables

Examples:
- T&E
- Taxes / Regulatory Payments
- Utilities

Source
PO-Based Spend
Non-PO Based Spend
Report - Measure
Lower Process Cost
Measure Process efficiency

Organizational Transformation
Strategic Sourcing Councils
Procurement Operations / Compliance
Financial Interlock
Procurement A/P Linkage
Technology Platform
Skill Development

Source Buy Report - Measure
Technology Organization Processes Pay Report Buy Source
We deployed a common technology platform which allows us to efficiently operate on a global basis.

- SAP as core procurement and payables engine with Emptoris e-sourcing and IBM developed supplier portal
- Developed web based connectivity with global supplier base
- Detailed spend visibility and reporting
- Use multi-client platform for commercial clients who request technology support
Supplier Segmentation
We focus on rationalizing the global supply base to establish sustained competitive advantage

Supplier Relationship Segmentation

<table>
<thead>
<tr>
<th>Regional / Niche</th>
<th>Strategic / Core</th>
</tr>
</thead>
<tbody>
<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>Have marketplace leadership and share IBM objectives</td>
</tr>
<tr>
<td></td>
<td><strong>Target: 90% of spend</strong></td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Non-Strategic / Tactical</th>
<th>Emerging</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low impact and $ value</td>
<td>New technology / product differentiation</td>
</tr>
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</table>

Long-term strategic importance

Value Of Purchases

High

Low
Our execution resulted in significant achievements

<table>
<thead>
<tr>
<th>1993</th>
<th>Today</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sourcing Expertise in place</td>
<td>&lt;10%</td>
</tr>
<tr>
<td>Cost Savings Contribution</td>
<td>?</td>
</tr>
<tr>
<td>Supplier Quality Level</td>
<td>85%</td>
</tr>
<tr>
<td>Escapes/Bypases (Maverick Buying)</td>
<td>&gt;35%</td>
</tr>
<tr>
<td>Acceptable Business Controls (Audits)</td>
<td>55%</td>
</tr>
<tr>
<td>Client Satisfaction</td>
<td>40%</td>
</tr>
<tr>
<td>Electronic Catalogs</td>
<td>0</td>
</tr>
<tr>
<td>e-Enabled Suppliers</td>
<td>&lt;500</td>
</tr>
<tr>
<td>Electronic Purchases</td>
<td>&lt;20%</td>
</tr>
<tr>
<td>Buyer-less Transactions (&quot;Hands-Free&quot;)</td>
<td>0%</td>
</tr>
<tr>
<td>PO Processing time</td>
<td>30 days</td>
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<tr>
<td>Contract Cycle Time</td>
<td>6-12 mos</td>
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To enable the strategy we changed our skill sets...

<table>
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<th>Skills Deployed</th>
<th>1995</th>
<th>Today</th>
</tr>
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<tbody>
<tr>
<td>Procurement Focus on Suppliers and Markets</td>
<td>10%</td>
<td>50%</td>
</tr>
<tr>
<td>Procurement Focus on Clients</td>
<td>0%</td>
<td>8%</td>
</tr>
<tr>
<td>Engineer</td>
<td>2%</td>
<td>20%</td>
</tr>
<tr>
<td>Execution &amp; Fulfillment (<em>Transactional</em>)</td>
<td>70%</td>
<td>5%</td>
</tr>
<tr>
<td>Other</td>
<td>18%</td>
<td>7%</td>
</tr>
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Keys to a successful procurement transformation

1. Leadership Support and Willingness to Take Some Risks
2. Effective Governance and Involvement of All Constituencies
3. New Cultural Norms may be Needed
4. Information is Essential to Fully Leverage Spend
5. Transform Processes First
6. Think Globally and Act Locally
7. Enhance and Develop Skills
8. Exploit Technology to Support People and Processes
9. Embrace Suppliers’ Capabilities and Collaborate
10. Get Support… and Get Started!
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
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.
Global Procurement Ops Centers (Shared Service Centers)
We have consolidated our transaction processing into three low cost, efficient operations centers to support our global requirements

**Budapest, Hungary**
Provides support for European countries in 23+ languages

**Bangalore, India**
Provides support for ASEAN, Australia, Canada, New Zealand, and USA, in English

**Shanghai, China**
Provides support for Asia Pacific in English, Chinese, Japanese, Korean

**Sofia, Bulgaria**

**Ho Chi Minh City, Vietnam**

**Chengdu, China**

Plus 3 satellites centers

**Cost Savings**
- Global Delivery
- Shared Services
- Process Excellence

**Value Creation**
- Communities of excellence
- Speed of execution
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Thank you!

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