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Magnus Carlsson has written a book that is largely sensational. I have not seen any equal presentation of how an organization can operate efficient sourcing. The whole arsenal of methods and techniques available are integrated into their commercial context. This is a trained practitioner who generously shares his entire wealth of experience from Ikea, one of the most admired purchasing organizations in the world.

The book’s target audience is broad. It’s about how to run an efficient sourcing operation with relevance far beyond Ikea. I think anyone who in any way comes into contact with purchasing, executives in charge of streamlining their organization, purchasing managers, purchasers, and even students will benefit greatly from the book’s content.

Most books published and addressed to leaders within companies and organizations are written either by researchers who try to popularize the material with pedagogical examples or by practitioners who explains ‘how it was’ or ‘how to do’. The latter are often well-known names that have held high positions in companies. As a rule, however, they deliver a perspective from above, without getting particularly close to the processes involving customers and suppliers, where the real value is actually created.

This book has been written by a practitioner who has long and varied experience of working close to the business. But it is not only a piece of writing that conveys the practitioner’s experience and gives good examples of how to create value by clever sourcing; it is also written by a person who is at home in purchasing theories, how markets work and in management issues. We have, in other words, an inverse relationship compared to the typical researcher as an author. It is likely that Magnus Carlsson is relatively more versed in the theories than the researcher usually is in relation to the empirical data and the examples he or she uses.

Category-based sourcing is widely discussed today but there is a very limited amount of literature that illustrates the subject. This makes this book so welcome. A very well-known book, which also addresses category based sourcing, is Jonathan O’Brien’s best-seller *Category Management in Purchasing*. It is very good and presents the guiding principles for the approach in question. In comparison Magnus Carlsson’s book goes one step further. It does so by describing, in a detailed and practical manner,
how it is actually possible to take advantage of the potentials of such an approach. The book is thus an important complement to, and in many respects an extension of, O’Brien’s text.

Björn Axelsson
Professor, Stockholm School of Economics
The moment of truth

“Luck is what happens when preparation meets opportunity.”
ATTRIBUTED TO SENECa, 4BC–65AD

**FIGURE 6.1** Activities in the IMPROVE step of the DMAIC process

![Diagram of DMAIC process with steps labeled Define, Measure, Analyse, Improve, and Control, and activities such as Project directive, Spend analysis, Positioning, Tendering, etc.]

**Tendering**

It is a common perception that competitive tendering automatically leads to positive results. Those who feel comfortable with this conclusion use it as their main tool – sometimes it’s even the only tool – and try to solve all purchasing problems by collecting as many suppliers as possible and allowing them to bid for the business. However, depending on the situation, the preparations and the execution of the tender, the outcome can range from increased prices and deteriorating relationships to lower costs and advantages on the market. Successful tendering processes are characterized by having:

- an adequate number of *suitable suppliers* willing to compete for the business;
- a sufficient number of *identified opportunities* to reach the goals;
- external and internal *influence* enough to develop the business.
The three points above are preparations completed either in the MEASURE step or in the ANALYSE step. In addition to this, the team also secures:

- a tendering process focused not only on prices; it is also used to further penetrate the value chain and the suppliers’ cost calculations, and to explore different options for solving the task;
- a tactical approach to the tendering process that maximizes the opportunities available;
- a well thought-out and well-planned tendering process carried through with precision. The team sets an example by never causing delays or confusion. Details are quality assured and the suppliers, who may be from different parts of the world, can easily understand what is expected of them.

But what happened to the prioritized suppliers? Are they participating in competitive tendering? Most of them participate, but from a different starting point compared with other suppliers. Many of them have a significant share of their volume in long-term contracts, a few of which were made in the value analysis in the ANALYSE step, and others that were a part of the overall preparation before the project was initiated. Thanks to development work carried out over a long period they have every opportunity to be competitive and, if they are not, the alarm bells will ring. Products not tied into long-term contracts are part of the tender, independently of which type of supplier manufactures them today.

Until now, the process has been characterized by problem-solving with structure, but from now on the perspective is reversed to structure with problem-solving. The team has a good idea of how to proceed but the execution requires accuracy. The tendering process is divided into (A) preparation, (B) request for quotation (RFQ)/request for proposal (RFP) and (C) negotiation.

**Preparation**

The team starts by ticking off the checklist and double-checking important details:

- Are there sufficient numbers of qualified suppliers available? What is their capacity? What volumes and products do they want to supply?
- To what extent have the capabilities of the potential suppliers been verified? Are there suppliers who might not be good enough? Can they be easily verified? Are they needed?
Strategic Sourcing and Category Management

- Is the technical documentation up to date? (Obviously in this area the 80:20 rule does not apply – everything has to be accurate.)
- Is there a plan for the approval of samples, including capacity booked in the test laboratory?
- Are the commercial conditions, such as forecasts, etc, up to date?
- Does the team possess sufficient resources to manage the entire tender process, for example analysts, technical competence and resources from the business units?

The tendering process is designed with daily-level activities. One of the most important ingredients is to maintain a fast pace with a clear timetable, as both the suppliers and the company must be able to schedule resources. Important national and religious holidays are respected, and in some cases the whole tendering process has to be arranged around the harvest season in order to secure prices and availability. Those involved must keep to the timetable; if the team begin to tolerate delays, the whole process may falter. The bigger the tender is, the higher the need for precision and clarity.

The team is now creating the basis for suppliers’ quotes, often a RFQ, which is a call for tender where suppliers are asked to submit quotes on defined products and conditions. It is also common to use a RFP, which also encourages suppliers to provide suggestions for new solutions and different alternatives.

The team decides what information they should be asking suppliers for, what options they should offer prices for, scenarios that are saved for the negotiations and whether products should be grouped into packages. Normally the team would ask suppliers for a base price, with a specified volume for a defined product, to continue with questions about discount rates for different variants, for example:

- **Increased volume of the product families.** The biggest families, where dual or multiple sourcing is sometimes used, can be divided into packages consisting of, for example, where suppliers make a basic quotation for 25 per cent of the volume, and discount rates are given for 50 and 75 per cent of the volume.

- **Increased overall volumes.** This differs from the previous point in that it refers to overall volume increases from the supplier, ie across all the products the supplier delivers.

- **Long-term contracts.** The length and the discount on these contracts depends on the conditions it gives the supplier to improve its competitiveness:
– The contract can enable the supplier to invest in special equipment, leading to higher efficiency with lower prices and better quality.

– A long-term contract means that the supplier benefits from the ‘learning curve’. This phenomenon was discovered in the USA in the 1920s and showed that the number of man-hours in production drops by 20 per cent every time the number of produced units are doubled. In 1995, Stewart, Wyskida and Johannes estimated this effect to be 10 per cent in simple industrial production like welding operations.

In other words, the team expects a longer contract to result in reduced throughput time per unit manufactured, which also happens in reality. The freed-up capacity can be used to lower the prices or increase the volumes. It is almost always better to increase volumes compared to reducing staff, especially if it is possible without additional investments. The saving made by cutting 10 per cent of the production staff would, depending on the industry sector, result in a cost reduction of perhaps 1 per cent. An increase of the production volume by 10 per cent will, if the fixed costs are 40 per cent, generate a 4 per cent increase in revenue, which can be shared. Furthermore, the company will usually not get a share of the supplier’s internal savings whereas the impact of volume increases, is subject to negotiation.

● **Risk premium.** This includes risks for changes in currency exchange rates, raw material prices and even fluctuations in sales volumes. In long-term contracts, it is usual to specify exchange rates and raw material prices; and if these vary over an agreed percentage the prices are revised or renegotiated. When the team discuss longer contracts with a supplier, they clarify how large a risk premium the supplier works with and try to find ways to minimize it. Sometimes, the total cost of risk is reduced by it being taken over by the company, for example by guaranteeing volumes or by assuming the currency risk. It is especially worthwhile when the customer is large in relation to the supplier and can balance the risks in a portfolio, with the same principle as any insurance company.

● **Different variants of product design.** These can be for specified variants (in the RFQ) or prices for variants suggested by the suppliers themselves (in the RFP).

The questions the team uses are not random selected; they are based on a solid understanding of the potentials and the suppliers’ wishes. The team
has a good overview of the entire situation and what the suppliers are most interested in. But they should be frugal with scenarios in the RFQ, not more than two or three. If they are too numerous, they are not treated with the respect they deserve. When the team has more scenarios, they can preferably be saved until the negotiations. There are also individually designed scenarios for the key suppliers, which also are saved for the negotiations. Additional points that are prepared:

- **Confidentiality agreements.** The team will be requesting a lot of information from the suppliers, and the suppliers will only share this if they are confident that it will be treated correctly – and that they will benefit from sharing.

- **Establish the rules.** What should the team do if a supplier refuses to show the costs in the value chain? What should they do if someone is three days late? Most teams feel that it is manageable if a supplier refuses to submit product cost calculations; and in fact there are few, if any, who refuse. These suppliers cannot receive any detailed feedback but they still compete with the rest. Delays will, generally speaking, result in the supplier being excluded. It may seem strict, but if the supplier starts with being delayed, it says something about their ability and interest in the business.

- **Information.** How should information be handled internally? Who manages the database? Where is information kept? What information is spread outside the core team? Which systems should be used?

- **Start-up meeting with the suppliers.** The purpose of the meeting is also to further stimulate the suppliers’ motivation, to clarify the process and to provide general business information. A start-up meeting can be a discussion with a single supplier or a large meeting with hundreds of people. The start-up agenda includes:
  - marketing of the company, the business and the excellence of cooperation;
  - commercial background and the goals of the tendering process;
  - a detailed description of the process, rules of the game and an introduction of the IT system.

- **Principles for the selection process.** There will be natural points during the process for the team to deselect suppliers, especially in RFQ1 and RFQ2. Almost all tendering processes benefit from two RFQs before negotiations. It can also be useful to establish a guideline for how many suppliers will be deselected at each stage.
The Moment of Truth

**Figure 6.2** The number of suppliers at the different stages of the tendering process

If the team has a lot of influence, they can let the suppliers know the principles to help them to do their best at all times, and not to try to save their potentials to the negotiations, risking being excluded in the process (Figure 6.2).

**RFQ/RFP**

The administrative handling of tenders and quotations is best done in an internet-based system that can handle documentation, which ensures that everyone receives the same information and helps to manage quotes, calculations and scenarios.

It is important that the questions in the RFQ are quality assured so that they will not be misunderstood. They are also formulated so that the answers are short and can easily be summed up and compared for future reference. If the team wants suppliers to specify the cost eg for a metal profile, they need to specify which cost: cut to shape or not, with or without material handling cost, gross or net consumption and with or without profit.

RFQ is not a negotiation and the team’s main instruments are comparisons and feedback. The RFP on the other hand invites more in-depth discussions and problem-solving. The RFQ feedback is tailor-made for each supplier, including a short description of the overall position, how they compare with other suppliers and a comparison of important factors (see Figure 6.3).
It is not unusual for the difference between individual supplier’s offers in RFQ1 and RFQ2 to exceed 5 per cent. RFQ 2 ends with an additional feedback to the supplier and an invitation to further discussion, or ‘Thanks but no thanks’.

**Negotiation**

The headline ‘Negotiation’ can give the false impression that this is an isolated activity that is taking place at one time. In fact, a large part of the entire process is a mix between problem-solving and negotiation, for example discussions during visits to suppliers and the spreading of information both internally and externally. All communication is part of the team’s efforts to create a favourable position and when they arrive at the negotiating table they are well prepared. They are familiar with costs and value chains, and know more about the supplier market than many of the suppliers. Suppliers who cannot be seriously considered have already been dropped and most of the horse dealing is in the past. The team has a good understanding of the suppliers’ motives and the suppliers in their turn know what the team is asking for. A large part of the negotiation is spent in discussions and problem-solving – even if the tension can be palpable. Preparations include:

- Relevant information regarding the supplier, including at least:
  - competitiveness per product range and overall for the supplier;
  - current business, volumes, product range, development and performance;
  - the results of the RFQ including strengths and weaknesses compared with other suppliers;

<table>
<thead>
<tr>
<th>Variable costs:</th>
<th>Sup. A</th>
<th>Difference vs competitors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Metal, sheet</td>
<td>24</td>
<td>+ 5</td>
</tr>
<tr>
<td>Metal, profiles</td>
<td>60</td>
<td></td>
</tr>
<tr>
<td>Fittings</td>
<td>12</td>
<td>+ 1</td>
</tr>
<tr>
<td>Packaging materials</td>
<td>6</td>
<td>+ 4</td>
</tr>
<tr>
<td>Paint</td>
<td>24</td>
<td>+ 1</td>
</tr>
<tr>
<td>Energy</td>
<td>2</td>
<td>+ 2</td>
</tr>
<tr>
<td>Direct salary</td>
<td>11</td>
<td>+ 3</td>
</tr>
<tr>
<td>Other</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>Fixed costs including profit</td>
<td>75</td>
<td>+ 15</td>
</tr>
</tbody>
</table>
– the likely objectives of the supplier;
– the team’s goals in the negotiation;
– possible scenarios and available bargaining points or concessions.

● It is an advantage if key people from the business units and stakeholders participate in the negotiation, both to contribute in the negotiation and to share responsibility for decisions made.

● If the team is covering a large segment, it is particularly important that they are able to simulate the impact on the overall picture as individual variants are being discussed. What is the impact on the total segment if the supplier offers lower prices on one product provided the volume is 20 per cent higher?

● Definitions of roles are always important, particularly if the team includes people who are not experienced in negotiations or who do not fully understand the process.

● The suppliers are invited, starting with the least interesting and ending with the most interesting. This means that the team initially tests the boundaries, hypotheses and different scenarios with the less important suppliers in preparation for the most serious discussions. They rarely reach an agreement with the least important suppliers during a negotiation, but they may do so with the best ones.

● At the end of every negotiation, key points are documented and signed off by both parties.

How big is the potential in negotiations? Negotiations have two main tasks: to create value and to distribute it between the parties. In the type of process that I describe, the value that is created in the final negotiation is usually not big. The business has already been thoroughly analysed in the earlier stages and the money is, to a large extent, on the table. The potential in the distribution of value – ie more or less qualified varieties of ‘if you do A, then we do B’ – is greater. My experience in these processes is that 2–5 per cent savings versus RFQ 2 is common. This differs greatly, however, from supplier to supplier.

In addition to direct savings, the negotiation also ties up loose ends. Questions that might not have been the important in the process, such as a continued development in logistics, product development or quality, are now being discussed. The list can be long, but the point is that the team treats the whole relationship with the supplier, and not only the performance that has been requested and offered. It clarifies the expectations of
cooperation and parries that all improvement requests will initiate new price discussions.

Contracts

Most companies working with category sourcing have an operating contract structure. I will therefore not deal with this subject.

Implementation

One euro that is implemented is worth more than 10 million that just remain as an idea in a presentation. Implementation is as important as the entire sourcing project and it should not be taken for granted. My experience is that projects where several business units or functions carry out the implementation have an average execution rate of about 80–85 per cent of what is agreed with suppliers. The rest is lost in vagueness or lack of competence, or gets negotiated away by skilled suppliers.

The best implementation I have seen is characterized by the following:

- The implementation is realized as a project, following the same discipline as the whole sourcing project: steering group, follow-up, action plans and a big portion of attention and encouragement.
- The project manager for the implementation has played an active role in the sourcing project. This is important for the continuity and understanding of the business and it also means that the project manager feels responsible for decisions taken in the project.
- The project is documented, but not by putting every document into files; the material is often far too extensive to be useful. Instead, special documentation is produced solely for the benefit of the implementation. This should contain, among other things, an overview and listing of all decisions. Records of decisions taken, both internal and external, are numbered and can easily be retrieved when needed.
- Good conditions for business units and users are created. This can be anything from issuing instruction material to providing practical education and training. Apart from the practical information, you sometimes need to hold discussions so that conclusions that are obvious to the project team can become equally obvious to the organization at large.
These are just some examples of activities. What has to be understood is that implementation is a part of the sourcing project and it is the team’s responsibility to create the right conditions for it.

Reflections

What creates the success?

Sometimes the tendering process and, perhaps even more, the negotiations themselves, are perceived by many as the ‘real work’ – even as the core of the purchaser’s skills. The tender can be exciting and good fun, but the only thing it proves is whether the team has developed a strategy with adequate potentials, suitable suppliers and sufficient influence; as Feynman might have put it, they compare the guesses/strategy with reality.

It is the work of the first three steps, DEFINE, MEASURE and ANALYSE, that distinguishes strategic sourcing from tactical: strategic sourcing is firmly anchored in the whole business development and creates situations that provide the conditions for desired results. If the preparations have not been made, the tendering process will not create successful and rewarding results. It is, however, relatively easy to fritter away good preparations in a badly managed tendering process and above all through poor implementation – which is just as annoying as it is common.

Supplier relations

One challenge for the team is managing relationships with key suppliers throughout the tendering process, especially if the team is well prepared and has a lot of influence. The sourcing process is neutral, efficient and carried out with an almost surgical precision – but there is a life after the agreement and the company needs to have good relationships with key suppliers. It does not mean that the team refrains from obtaining the results, but they must manage relationships in a good way:

- The team keeps the dialogue open with the key suppliers and gives them guidance. Not in the form of competitor information or secrets, but in discussions about the supplier’s threats and opportunities in ways beyond bar graphs and emails. The key suppliers need to feel that the team wish them well, in a way that benefits the business and does not compromise on professional conduct or moral integrity.
Orders are transferred between companies but relationships are created between people. The company will not change established relationships overnight; those who work with suppliers on a daily basis will not suddenly take on the role of a neutral analyst. The supplier’s closest contacts continue to work with activities that improve the supplier’s competitiveness, while people who do not have a daily relationship with the supplier manage the project.

If and when the team has power, they use it in the right way. They avoid exploiting situations in a way that is perceived as greedy. This does not mean that they shy away from negotiations, from putting pressure on suppliers or from realizing results, but it does mean that they do not only concern themselves with the numbers.

How does the number of segments included in the project affect the work?

When additional segments are included, the complexity in the tender process increases, with more possible synergies, variants and scenarios. For experienced teams this is positive since it opens up the possibility of more and better solutions. At the same time it is important to stay focused and not to ask all suppliers for everything; it can lead to a complexity that neither the suppliers nor the company can handle. The work of the preparatory steps is also affected by the following:

- The segments are continuously compared with each other, for example in the spend analysis, the market investigation and in the value analysis. The aim is to determine the difference in the value potential between the segments. This means in practice that the team asks the question: which segments can provide the desired customer benefit at the lowest total cost?

- In the ANALYSE step the purchasing volumes, ie the number of products or users, are shifted towards the segments that provide the best value. For example, the passenger journeys by high-speed train could be increased and air travel reduced, or more products could be developed in chipboard and fewer in solid wood. This can affect the supplier structure and the tender process.
Strategic Sourcing and Category Management

Lessons Learned in Ikea

BY MAGNUS CARLSSON

“I can really recommend this book. It’s an excellent description of how to design processes and a competent organization to create value in a supply chain.” Arja Taaveniku, Chief Officer and Supply Chain Officer, Kingfisher

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