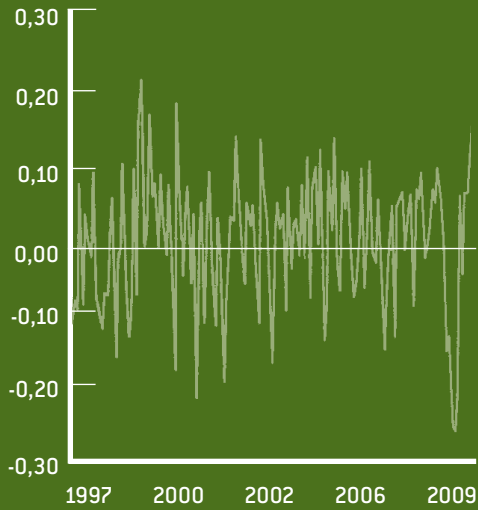


think:act CONTENT

Fresh thinking for decision makers

Regarding procurement, less is more – sometimes | The global recession has curbed demand for many resources and created overcapacity | What was once a supplier's market is now a market in which the buyer has the upper hand | Now is the time for a smart restructuring of your supply base |

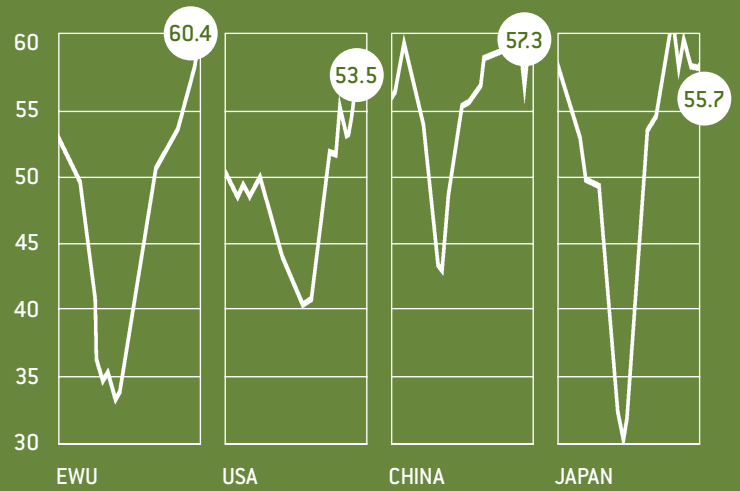
VOLATILITY IS THE NEW REALITY



OIL PRICE DEVELOPMENT (BRENT) IN PERCENT TO PREVIOUS MONTH

Source: IMF, Roland Berger Research

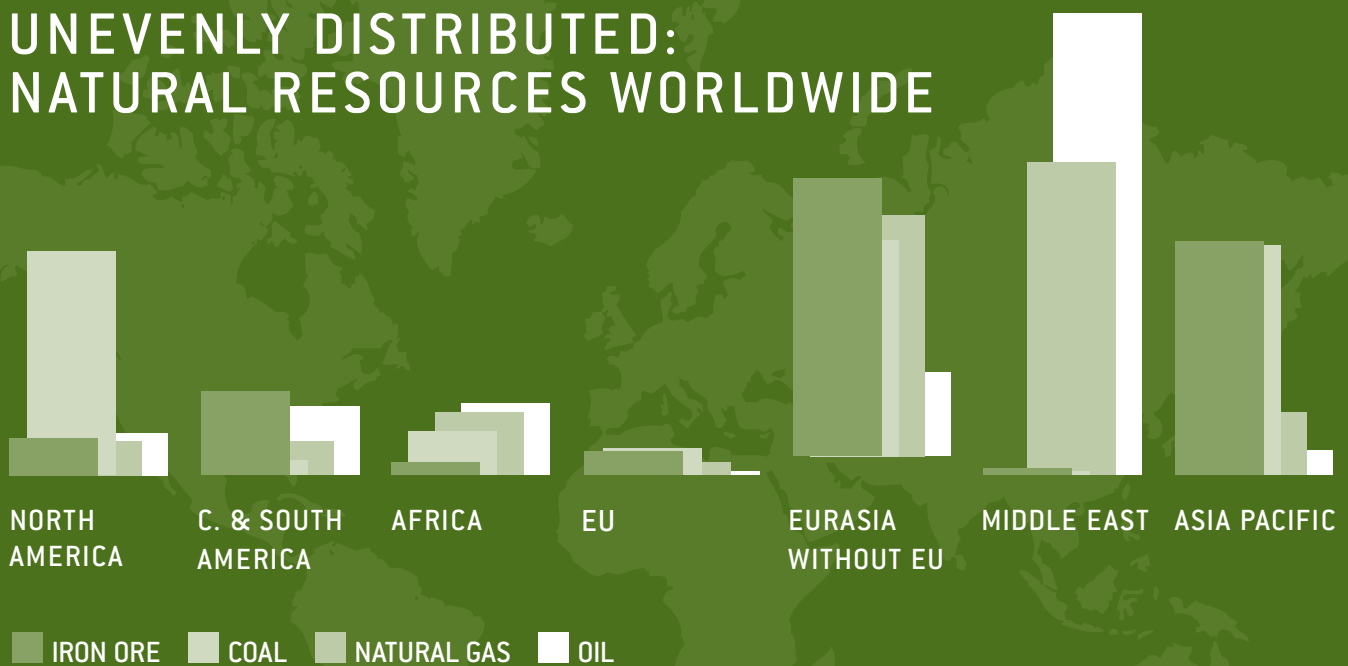
GLOBAL BUSINESS OUTLOOK



PURCHASERS MANAGER INDEX, JANUARY 2008 TO APRIL 2010

Source: BME

UNEVENLY DISTRIBUTED: NATURAL RESOURCES WORLDWIDE



Source: Roland Berger Research

WHEN IT COMES TO PROCUREMENT, LESS IS MORE – SOMETIMES

OVER THE PAST TWO YEARS COMPANIES AROUND THE WORLD HAVE FACED A DRAMATICALLY CHANGING ENVIRONMENT WITHIN WHICH TO MAKE PROCUREMENT DECISIONS. AS THE GLOBAL ECONOMIC CRISIS SENT PRICES FOR RAW MATERIALS TUMBLING, THE PENDULUM SWUNG DECISIVELY IN FAVOUR OF THE BUYER. BUT THE BUYERS' GOD FORTUNE DID NOT LAST. IT TOOK SURPRISINGLY LITTLE TIME FOR MOST PRICES TO REBOUND. NATURAL DISASTERS AND DIPLOMATIC DECISIONS FURTHER BOOSTED THE COST OF SOME RAW MATERIALS. IT TOOK THE OPEC OIL CARTEL LESS THAN A YEAR TO DRIVE OIL PRICES FROM USD 30 TO USD 70 A BARREL BY CUTTING ITS PRODUCTION. IN CHINA AND SOUTH AMERICA EARTHQUAKES SHUT COPPER MINES, INCREASING PRICES IN THE BASE METAL.

The contrasting developments – windfall profits due to a sharp drop in prices for materials and services combined with the prospect of prices shooting up due to resource scarcity in the medium to long term – mean companies must rethink their purchasing management right now. This is the right time to sustainably ensure and capitalize on the opportunities of recent months.

TRACING THE ROOTS OF THE DEVELOPMENT

The recession sent the commodity markets on a roller coaster ride. By the end of 2008, the economic crisis had brought the global commodities rally to an abrupt halt. After seven consecutive years of oil price rises, which culminated in a record peak of USD 147 a barrel in the summer of 2008, prices collapsed to near USD 30 a barrel. By late 2009, they had recovered to USD 70-80 a barrel. Other commodities experienced similarly wild rides, with some recovering their losses, and others, such as natural gas, remaining depressed.

Many commodities, including most metals, remain in oversupply, even though some of the volume has been soaked up by speculators.

For the long term, there is a general belief that robust growth from developing economies, especially in Asia, will again improve suppliers' fortunes. The rush for a finite supply of natural resources eventually will recreate conditions witnessed before the economic crash, many forecasters opine. However, in the medium term – over the next 3-5 years – an excess supply in many commodities could mean buyers, rather than sellers, retain the upper hand they are only slowly realizing they gained when financial markets collapsed and the world's economies followed.

These developments will lead to sweeping change in single-firm procurement in all four important fields: Raw materials, production materials, non-production materials/services and traded goods. However, the time companies have for making adjustments along their supply chains is limited as raw material prices already have begun to rebound.

I. HOW TO MANAGE VOLATILITY OF RAW MATERIALS STRATEGICALLY

Companies have a number of ways they can respond to the volatility in raw material and energy costs. Roland Berger's approach to this challenge follows a straightforward seven-step logic:

SUPPLIER BECOMES BUYER MARKET

Now is the time for rethinking procurement



VOLATILE OIL PRICE

Oil prices as well as other commodities experienced wild rides



Source: Roland Berger Research

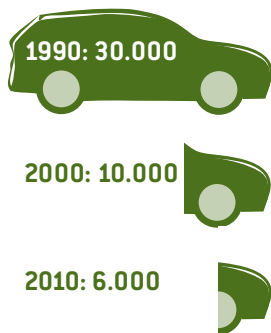
SEVEN STRATEGIES TO MANAGE RAW MATERIALS

1. Use **planning scenarios** and active risk management/hedging
2. **Map out the procurement risk** on the sales market using index-based pricing
3. Anchor sustainability initiatives to **reduce materials use**
4. Use **suppliers' innovations** from concept competitions to optimize raw materials use
5. **Identify alternative raw materials**
6. **Design a supplier basis** using strategic value-adding collaboration and backward vertical integration
7. **Set up multiple-year agreements with suppliers** of raw materials to ensure price advantages in the preferred currency using index-based pricing

These strategies are flexible and can be tailored to each company's individual circumstance.

DRASTIC REDUCTION: NUMBER OF SUPPLIERS IN THE AUTOMOTIVE INDUSTRY

Decline of 80% within 20 years



Source: Roland Berger Research

"NO RISK" IS ALWAYS BETTER

Triple A = Default risk is almost zero



II. A BUYER'S MARKET: SHIFTING TRENDS IN CORPORATE BEHAVIOR

Until recently, manufacturers were beholden to energy companies, which could dictate market prices. Copper, zinc and nickel are dominated by a handful of providers with a market share of around 30-50%. The global recession and weaker consumer demand, especially within the OECD, have markedly changed these dynamics. The dip in the market has been positive for resource-heavy industries. Rising prices had forced these companies – including those in the automotive and airline industry (large consumers of raw materials) – to critically reevaluate their product portfolio over the past year. Now, they are in a dominant position: It is a buyer's market. As a result, they can make new demands on their suppliers. This reemerging strength in the relationship looks to have a longer-lasting effect on procurement than in previous cycles. Suppliers must respond to this lower demand by adjusting their global footprint design and their overall capacity.

III. CREATE THE CORRECT STRATEGIC PARTNERSHIP

The typical merger and acquisition route presents one way of avoiding bankruptcy among suppliers. Roland Berger is increasingly advising entrepreneurial businesses to engage in strategic partnerships that create mutually beneficial outcomes for buyers and sellers. Like many others, consumer products giants Philips and Sony are cutting the number of their suppliers in half. Car manufacturers, including GM and Ford, are planning to significantly compress their supply base. But instead of simply dismissing their suppliers, all four of these companies have explored partnership arrangements to allow their preferred suppliers to weather this storm. The most common form of partnership involves innovative ways of extending the financial liquidity of a supplier to allow it to stay afloat and produce at cost. In addition to financial risk management, buyers evaluate potential strategic partners on an individualized set of criteria. This can include manufacturing know-how, quality of materials provided, reliability of service (i.e. timely provision, low transportation costs, etc.) and other key factors to rein in risk.

The following sections will look at how buyers should select preferred suppliers and what suppliers can do to become attractive, long-term partners.

SUPPLIER RISK ASSESSMENT

It is crucial to manage risk when choosing preferred suppliers. Difficulties can emerge at any part of the value chain. It is critical to test the financial viability and evaluate the credit ratings of the main supplier and all of its component producers. Capabilities of producers need to be vetted for their financial reliability within a customized matrix to speedily determine corporate risks and to allow for a uniform evaluation of all candidates. The matrix should include levers to objectively measure the macroeconomic and sector-specific operating context (industry rating).

Once these risks have been measured and assessed, companies can consider various forms of collaboration. Traditional "big spenders", such as manufacturing giant Bosch, have created new payment structures together with their main suppliers. The company has negotiated a deal for its copper supply, which leverages its purchasing power with raw material vendors. This takes the payment burden from suppliers under the condition that they fulfill all their other contractual obligations.

Hedging instruments, such as futures and options, are also valid tools with which to reduce raw material price risk. One leading aerospace engine manufacturer saved more than EUR 20 million by using hedging instruments to protect against nickel price risks. Mining companies Vale and BHP Billiton recently reduced the time span of their contracts for iron ore in Japan from 12 to 3 months. They also included a clause that allows a 90% price increase from quarter to quarter. These measures will cause higher volatility and increase the price risk for buyers of ferrous metals, prompting an even greater need for careful hedging. But hedging is not risk-free. Companies can lose money, especially if the time span of financial instruments is not flexible enough to cover the requirements of the highly volatile raw materials markets. Markets such as these require strategic hedging portfolios that include different instruments of various longevities. Such sophisticated portfolios should further reduce the risk of financial losses.

Other models include extended payment options, such as those pursued by a number of car manufacturers, including Fiat and Renault. They have – on different occasions and depending on their relationship with the supplier – accepted the cost of materials and the liability for credit lines. In return, suppliers have committed themselves to longer-term cost reductions. These new types of collaborative engagements help ensure timely delivery of high quality materials.

SUSTAINABILITY SELLS

In addition to evaluating their suppliers on the basis of financial management skills, buyers can also have a lasting effect on the way their partners conduct business. They can do this by adding other conditions to preference agreements. Sustainability criteria are one such measure: Are miners using environmentally sustainable practices in the provision of the raw materials they supply? Given its environmental impact, is tapping Alberta's oil sands a practice buyers want to see continue? For Whole Foods Market, the organic grocery chain, and Bed Bath & Beyond, the household goods company, the answer to the second question

PROTECTION REQUIRED TO RESTRICT PRICE RISKS



Source: IMF

ABSOLUTE VALUE OF ALL SUPPLIER CREDIT IN EUROPE

31 May 2010

EUR 2,886 bn

Source: Roland Berger Strategy Consultants.

ENVIRONMENTAL AND SOCIAL COMPATIBILITY BECOMES THE NORM

More and more companies include sustainability measures in their supplier assessment



appears to be "No". In an effort to shrink their own carbon footprint, both businesses moved earlier this year to shun suppliers that source their fuels from Canada's oil sands.

It is precisely because their customers demand such action that companies can in turn demand more from their suppliers. Consumer goods and life sciences companies such as Procter & Gamble, Unilever, and Henkel are rewriting the rules for strategic partnerships to include sustainability measures. Automotive manufacturers, including Mercedes Benz/Daimler (Blue Tech) and Toyota (for its hybrid vehicles), have taken similar steps to force their raw materials contractors to live up to best practice standards.

Similarly, purchasing companies are scrutinizing the anti-corruption standards of their providers, especially those operating in emerging economies. Value-based production has become a hallmark and a differentiating factor in the globalized economy, boosting the importance of corporate social responsibility. Dealers that fail to comply with a company's CSR portfolio, or with any of the other measures cited above, will find it more difficult to secure strategic partnerships.

METRO Group, one of the world's biggest international retail companies, recently announced the creation of a "Sustainability Board", whose members will include the company's CEO and COO. The efforts of Swedish furniture giant IKEA are further advanced: The company's outstanding CSR management was recently honored with a coveted "Fair Trade" award in gold.

IV. PROTECTIONISM REARS ITS UGLY HEAD

Innovative arrangements between customers and suppliers, such as those mentioned above, need the support of a truly competitive natural resource market, one that is not dominated by monopolistic behavior and beholden to financial speculation. Even after the crisis, which prompted a drop in demand for most natural resources, nationalism continued unabated, negatively affecting trade in natural resources. Governments around the globe are becoming increasingly involved in trying to guarantee their nation's supply of resources. Their methods may differ. For example, German companies have partnered with Gazprom, the Russian gas supplier, to build direct pipelines between the two countries, while the Chinese government has sent its national oil companies to buy oil fields in Africa and beyond. Either way, the goal is clear: To secure a nation's supply of energy and other natural resources.

PUTTING THE 'NATIONAL' IN STIMULUS



Such measures are particularly prevalent in countries where resources have driven rapid economic growth in the past and now represent the best hope for a speedy recovery from the global downturn.

China is not the only country throwing its weight behind its own companies. The economic crisis is having other deterring effects on competition. National economic stimulus packages, including the popular (and now extended) US "Cash for Clunkers" program and the country's infrastructure packages, have "Buy American" (or 'buy national') clauses embedded in them. Though they do not completely rule out international project bids, the hope is that national champions will "help put our nation on the path of global success – even in a world with more

powerful players,” according to Nina Hachigian at the Center for American Progress. Similarly, China is allowing only its own companies to vie for its stimulus contracts in renewable energies and the European Union is upholding specific standards for its infrastructure projects that favor contractors from member states. How can foreign global companies react to these ‘adverse’ conditions, when political lobbying is unlikely to bring desired results? One answer may be that companies – as part of their global capacity adjustments and strategy – have to strengthen their local base, their local supply network and their local knowledge and influence.

But there might be industries, including aerospace and defense, where even that is not enough. Some projects are obviously just too politically sensitive to leave to “foreigners”. Companies would be wise to figure out which projects are lost causes before investing too heavily in competing for them.

V. HARNESSING NEW OPPORTUNITIES – KEY LESSONS

Now is the time for companies to harness the fundamental market shifts to their advantage by making smart, lasting changes to their entire supply chain. Significantly reducing the number of a company’s suppliers can create a new beneficial, competitive dynamic among the remaining, most important product groups.

However, fewer suppliers lead to greater interdependency between procurer and supplier. This makes forging strong, strategic and sustainable relationships with the remaining, smaller number of suppliers even more important. In volatile situations, good risk and cash management becomes essential. Contingency plans and safety nets must be in place to identify and deal with the risks of supplier insolvency and the violent fluctuations in commodity and currency markets.

To circumvent the barriers put in place through “buy national” clauses, buyers must add country of origin criteria to the matrix they use to evaluate suppliers worthy of strategic partnerships. Now more than ever, competitiveness depends on a delicate balance of many factors. These include financial viability, overall sustainability and the nationality and industry of suppliers.

On the opposite side of the table, suppliers must be aware of the different dynamics at play. This will help them position themselves correctly so they can maintain and expand existing ties with their own suppliers while attracting new clients.

Finally: Decision-making in a rapidly changing environment means buyers must empower employees who make critical sourcing decisions. Central to this is giving key staff members the correct tools, such as the centrally developed matrixes outlined above. This will allow companies to make quick, accurate and innovative changes in development and supply chain management. To be successful, businesses must be able to rely on nimble employees wielding precise tools, rather than blunt, centralized procedures that lack the flexibility required to make the most of these fast-changing times. Act now! The opportunity is fleeting.

IF YOU HAVE FURTHER QUESTIONS,
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CORPORATE TO DOS: THE TIME IS NOW!

- USE THE MOMENTUM
 - Critically consider your supply chain
 - Compress your supplier base
 - Improve supplier relationship management
- GO FOR BIG DEALS
 - Establish strategic partnerships
 - Create smart multi-year contracts with flexibility and exit options
 - Manage supplier and currency risk proactively with consistent commitment
- PREPARE FOR AN EVER-CHANGING ENVIRONMENT
 - Push sustainable initiatives in the supply chain
 - Be aware of and prepared for national initiatives and protectionist trends
 - Empower your end-to-end supply chain and procurement organization

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