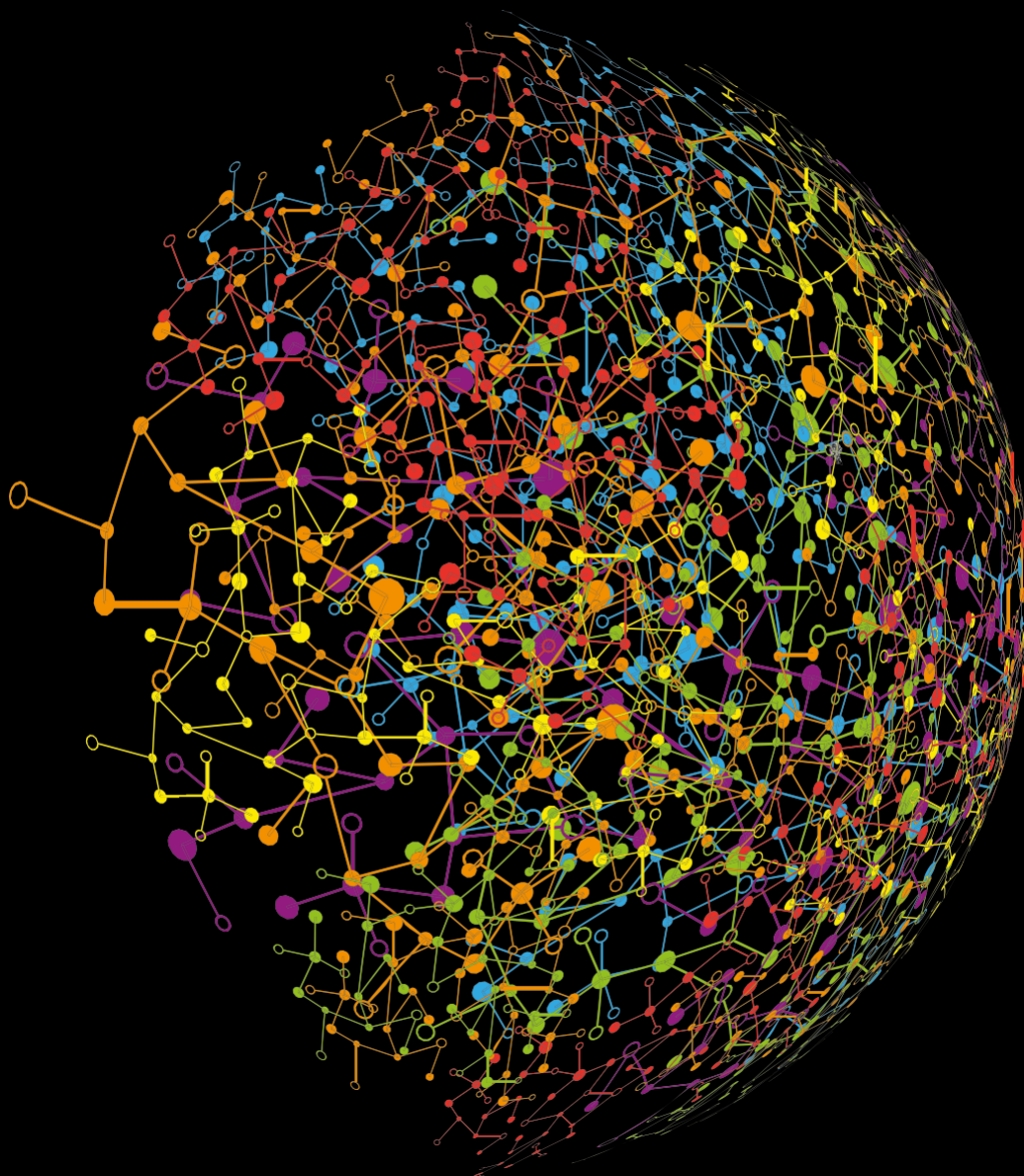


# Deloitte.

Supply Chain



## COVID-19

The Procurement role in Crisis Management



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# Introduction

On 11 March 2020, the World Health Organization (WHO) officially declared COVID-19 to be a pandemic, and the virus came to affect the population of more than 180 countries just one month later. We live in an exceptional situation, facing a period of great uncertainty that raises issues that require putting people's health first while trying to minimize the economic impact, with authorities around the world taking coordinated measures to respond to this emerging threat. In the same way, the business community is transferring these measures to its operations and is also incorporating additional actions to be able to face this context of tremendous uncertainty in which we find ourselves.

While the full impact of the virus will not be appreciated for months, it is undeniable that recovery will require unprecedented levels of coordination over an extended period. This recovery will be rewarded with valuable lessons learned that will be worthwhile for future management. The measures that companies are taking will lay the foundations for recovery and for a gradual relaunch of activity, after the pandemic has been brought under control from a health perspective.

Among the key figures in this crisis are Procurement leaders. With an essential role in the supply chain to guarantee supply, they are in turn strengthening their strategic and value-added position at organizations. Although under tremendous pressure, Procurement leaders are playing a proactive role in managing the crisis with the aim of reducing its impact and facilitating recovery.

This article sets out Deloitte's vision of Procurement's role in this crisis, the guidelines that these leaders are adopting and the future vision of the Function as a lever for growth in a previously unexplored environment that will lead us to a new normality.

# The Procurement role in Crisis Management

Supply chain management is a complex challenge, especially in crisis situations. However, it is precisely at these moments when the Procurement function should shine on its own merit. Not only because of the ability to deliver efficiency to the company, but also because of the capacity to deliver market value in-house, adequately managing risks with suppliers in periods of uncertainty. Now, more than ever, it is fundamental to make people see the importance of the Function and the leadership that their representatives are obliged to assume. For this reason, it is time - especially for companies that do not yet have this consideration - to expand the role of Procurement and give it an integral vision of the supply chain, involving it in decision-making at the highest level.

This requires aligning the role's objectives with strategic business priorities and adopting a holistic and coordinated approach. In that sense, the objectives of Procurement during this situation will be mainly two-fold: to guarantee the supply of critical products and services, ensuring business continuity through supplier management, contributing to the maintenance of the value chain; and to optimize costs through excellence in the contracting of suppliers, avoiding excess cash outflows.

In order to meet the first objective, the Procurement teams will have to manage, with methodology and rigor, the most appropriate strategies in their scope of action, working on the implementation of actions in their critical categories, based on correct segmentation, with a global vision of their suppliers and their risks, which are essential for decision-making.

Supply management with a healthy, balanced and diversified supplier pool is essential and the optimization of this pool needs to be very precise: strategic products and services and bottlenecks must be treated with the utmost care, ensuring supply and enhancing collaboration with suppliers who will become, more than ever, business partners. Furthermore, recovery will be leveraged on these strategic suppliers, helping companies to accelerate the ramp-up curve.

On the other hand, the search for efficiency in the short term is focusing on those families that are dispensable or, due to circumstances, should have their volumes reduced to the minimum necessary to ensure operation. Along these lines, the measures to be implemented must be highly selective and must take into account, must focus on segmentation by type of family or supplier and their importance for the business.

Regarding this second objective, alignment between Procurement and Finances will become extremely important in cash management. Financial solvency is one of the major concerns of companies at this time and Procurement is taking on a critical role in the development of the cash flow plans that are being implemented as part of contingency plans. Thus, the Function must provide this complete vision of the supply chain and incorporate it into cash management, identifying actions to be taken in relation to suppliers, categories and families.

For all these exceptional reasons, Procurement leaders are updating or building their annual plan from scratch as they face this complex situation.

# The Procurement role in Supply Assurance

The most exposed companies during the crisis are those with lower cash reserves or unstable cash flows that make maintaining the business unviable, even under minimal schemes. However, companies that have seen how their critical suppliers and business partners have been influenced by the above-mentioned points are also highly exposed.

For this reason, the integral vision of the supplier as an extension of our company is indispensable, not only with a view to the short term, ensuring immediate business continuity, but also with a view to recovery. The supplier's role will be fundamental in identifying changes and trends, as an agent at the beginning of the value chain and as a key entity to foresee possible structural changes in our business and in the market of the future.

Along these lines, collaboration with strategic suppliers that feed the value cycle will be especially important, attracting innovation to the company - innovation that is also aimed towards the concept of new normality -. Therefore, win-win collaboration with strategic partners through actions that balance liquidity and joint protection of the cash flow, ensuring the common good of the value chain, is also one of the best strategies to emerge strengthened from the crisis.

Additionally, remote working is forcing companies to change their work patterns and respond more immediately than ever before. Technology is becoming essential for this and only those with an optimal level of digitalization are currently able to properly manage business relationships, including the entire supply chain and, of course, management with suppliers.

It is precisely in supplier management that the Procurement role is vital.

# Supplier management and its associated risks

Although it is true that this crisis will most likely generate structural changes in many companies and sectors, Procurement is responsible for adequately managing its present and future pool of suppliers and also taking care of the value chains and the business itself.

With regard to the supplier base, inadequate treatment of the most critical suppliers can greatly affect the operation or image of companies. Along these lines, although risk management is a widespread mechanism at many organizations, there are situations, such as the current one, that exceed all expectations. Therefore, Procurement leaders have a privileged position, and great responsibility, in the management of risks associated with the pool of suppliers.

However, two out of every three Procurement<sup>1</sup> leaders do not feel fully prepared to face the risks they manage. The truth is that only 4% are fully capable, but this figure must increase considerably due to what is being learned during the crisis - if the measures taken are appropriate -.

This lack of preparation for external risks has historically been due to the fact that organizations identify so many risks that it is difficult for them to know where to focus their plans. For example, one in two organizations does not fully understand the nature of relationships with established third parties<sup>2</sup>. Another major problem for Procurement leaders is not having visibility beyond first-tier suppliers: 61% of CPOs<sup>1</sup> acknowledge that they do not have a vision of Tier 2 suppliers and beyond.

Some of the main criteria that are usually evaluated to prioritize risks from the Procurement standpoint include:

- Operational risk due to lack of supply
- Economic impact of contracting
- Supplier market complexity
- Delivery times
- Quality of the product or service
- Legislative or environmental restrictions
- Supplier financial risk
- Supplier operational risk
- Corporate Social Responsibility
- Reputational risk
- Fraud risk
- Tier 2 (and beyond) supplier risk

In this way, correct mapping and segmentation of the supplier pool - with specific technology as an ally - is key for defining specific plans. To do this, it is necessary to adequately assess the importance of each risk based on the supplier and the relative importance of each procurement category. In this sense, only 59% of organizations<sup>2</sup> work on risk with third parties based on their defined profile, and a common mistake is to use economic impact as the primary criterion. While it makes sense for financial exposure to be higher in the categories considered most important, this criterion may not present the most critical risk. This is the case for those products and services that may be a bottleneck to the transaction. In these cases, diversification of the supplier base is extremely important to ensure supply in the event of disruption. The trend towards macro-supplier management has meant that supply risks have grown exponentially as the world has become increasingly globalized, and this may be one of the structural changes or trends of change that will emerge from this crisis.

<sup>1</sup> Global CPOs survey 2019 - <https://www2.deloitte.com/us/en/pages/operations/articles/chief-procurement-officer-survey.html>

<sup>2</sup> Global EERM survey 2019 - <https://www2.deloitte.com/es/es/pages/risk/articles/gestion-de-riesgos-con-terceros.html>



## Technology

The most digitally mature companies have been the quickest to adapt to this new situation, while the rest are having to do so at great speed. In any case, and within the technological field, there is still a long way to go to ensure business scalability and responsiveness. Therefore, once we recover from the urgency of the crisis, it will be time to accelerate the adoption of supply chain technologies, especially within the Procurement function, through connected Digital Procurement solutions that cover the entire value cycle. We are talking about category management and advanced analytical functionalities, market intelligence, sourcing, contract management, P2P process automation and supplier management or risk management with suppliers, among other solutions.

Some of these technologies are widespread, but there is still much room for improvement, mainly in two areas, apart from their full adoption and use within the companies themselves. The first is in their interconnection<sup>1</sup>: approximately 40% of procurement departments work with watertight modules that do not talk to each other, with the consequent loss of value. Also, the technological map currently in use does not yet respond to certain specific challenges of the Function: while supplier risk management is a growing priority - as is being demonstrated - the adoption of ad hoc tools is still relegated to second or third place. These advanced supplier risk management tools<sup>1</sup> have an implementation rate of approximately 33%, as compared with 80% for more traditional solutions such as P2P or sourcing. These technologies are capable of mapping supplier networks up to Tier 4-5 levels, and can reach levels above Tier 10, developing customized profiles per supplier according to the supplier risk factors. Through them it is possible to accurately evaluate the health of the supply chain and design appropriate plans.

Other functionalities such as advanced analytics and artificial intelligence - to quickly identify which categories and partners should be given priority in a crisis environment - also have great potential for adoption: only one in five CPOs works with specific modules<sup>1</sup>.

No less important is the ability to now skillfully and effectively manage traditional tools such as contract management or sourcing in order to, for example, screen contracts for our critical services or review the status and act on tenders and ongoing projects. At this point, it is significant that 43% of organizations<sup>2</sup> do not have complete knowledge of the contractual terms associated with supplier relationships.

On the other hand, and although less relevant in this crisis - which has slowed down investment in emerging assets -, tools such as blockchain will also generate benefits in product and supplier traceability in the medium term.

Thus, it is especially important to pay attention to these technological enablers which will in all likelihood serve to accelerate the recovery curve.

<sup>1</sup> Global CPOs survey 2019 - <https://www2.deloitte.com/us/en/pages/operations/articles/chief-procurement-officer-survey.html>

<sup>2</sup> Global EERM survey 2019 - <https://www2.deloitte.com/es/es/pages/risk/articles/gestion-de-riesgos-con-terceros.html>

# The Procurement role in Cost Optimization

A crisis is a time of rationalization to preserve cash as much as possible, limiting cash outflows to carry out operations with guarantees.

Given the importance of cash management at these times, developing and matching the cash plan with the procurement plan is absolutely necessary to have a complete view of the cash flow. Along these lines, the CPOs work swiftly to ensure operations, redesigning their annual roadmap, which is the procurement plan. In order to do so, it is essential to observe the reconsidered perspective of the supply chain and coordination with departments such as Operations, but it is also critical to work with the approaches adopted by the CFO to manage liquidity, as they will impact upstream business relationships with suppliers and strategic partners.

Generally at any time of crisis, Procurement departments are often seen as internal efficiency boosters. Although most companies are naturally rationalizing costs in some of their categories due to the drop in consumption, other families can be optimized either by improvements in conditions or by eliminating certain internal demand. In order to identify these families, a highly mature, strategic procurement role is required, to allow the critical nature of each product or service to be intelligently classified and a clear image of the scope and potential actions to be obtained. It is time to analyze expenses in depth, trimming what really needs to be trimmed: if extreme precision is not implemented, the growth curve will be burdened and output will be weakened. Therefore, it is the moment to be more intelligent than ever when acting in relation to the supplier portfolio, with all the agents of the value chain coordinated in win-win actions in order to prepare the recovery. If any critical link in the supply chain is broken, it will inevitably damage the others.

With these new scenarios of needs, it is also necessary to be more agile than ever. Some of the most common adjustment actions are:

- Identifying critical projects to be maintained - after prioritizing them based on impact -
- Joint agreements with suppliers on agreed prices or volumes
- Agreed measures with suppliers regarding payment terms
- Redefining product and service specifications to match demand
- Considering alternative suppliers to broaden the supply base
- Converting fixed costs into variable costs - align equity with actual demand -

In any case, every well-executed action - however small it may seem - will be positive. Procurement departments must carry out the right rationalization strategy extremely swiftly so that there is no loss of business value and to ensure liquidity for their companies.



# Future Vision

Due to the barriers many companies are encountering when importing supplies, they are visualizing certain supplier relocation streams towards areas closer to their supply chains. Likewise, re-shoring or in-house manufacturing options are beginning to take on significance. Within this framework, and also with the aim of ensuring the reduction of production and delivery times, in addition to operational risk, certain movements in the market seem to indicate that local suppliers could play a significant role in the recovery. In that case, we would be facing a change of paradigm, with a growth horizon for small and medium suppliers. Until now, macro-suppliers have dominated the stock exchanges, simplifying relationships and generally offering good contractual conditions. With this crisis, a large number of these macro-suppliers have been overwhelmed by not being able to supply their customers, even preferential ones. This has led many Procurement departments to seek alternatives with suppliers of lower capacity, but with less operational risk and which, above all, are closer, with some of these suppliers gradually becoming business partners. Although this may occasionally represent a slight increase in terms of costs, it has been demonstrated that this criterion is not the most critical in situations such as the current one. Of course, it should not be neglected either: one of the lessons that every crisis brings with it is usually efficiency and rationalization.

It will be Procurement's responsibility to push the recovery towards the new normality, to lead the structural changes in the supply base through supplier management, where those changes will help to identify the changes taking place in the markets. As a function positioned in the companies' strategy and enabled by technology, it should be able to detect trends, attract value to be incorporated into the product cycle and ensure the viability of the business by, more than ever, using suppliers as true partners in the value chain.



## Authors

### Vicente Segura de Antonio

Partner  
Supply Chain practice leader for Spain  
Strategy and Operations Consulting  
[vsegura@deloitte.es](mailto:vsegura@deloitte.es)

### Imanol Martín Ortiz de Landázuri

Manager  
Procurement and Supply Chain Specialist for Spain  
Strategy and Operations Consulting  
[imartinortizdelandaz@deloitte.es](mailto:imartinortizdelandaz@deloitte.es)

### Óscar Martín Moraleda

Partner  
Extended Enterprise Risk Management practice Leader for Spain  
Risk Advisory  
[omartinmoraleda@deloitte.es](mailto:omartinmoraleda@deloitte.es)

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