

Innovate or die:

Why supply management is your most important asset



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They say that travel broadens the mind. On my return flight from a recent trip to China I had the opportunity to delve through the plethora of research reports, journal articles and thought pieces that had made their collective home on a far corner of my desk in the weeks preceding my trip.

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It is certain in my mind that this economic crisis has had a direct financial effect on all organisations, as well as their key customers and suppliers in all sectors of the economy. Organisations have had to re-consider their capital investments, cut budgets, and lower inventories, in an effort to conserve cash and establish a basis for stabilisation of the enterprise through the trough.

Following the storm, came the survival mind set and then a proactive and deliberate focus on the trinity of cash, costs and risk. It was Warren Buffet who said:

“...the value of a company is determined by the discounted value of the cash that can be taken out of the business during its remaining life...”

This clearly demonstrates the role of cash in creating shareholder value and which led me to contemplate the question, “how long does it take from when money is spent with suppliers to when it is collected from a customer?” This question in these cash strapped times must be on the minds of all CEOs and CFOs right now!

I wondered too how many organisations had capitalised on the “downturn”. According to the Hackett Group 2010 Key Issues Study, 73% of organisations they surveyed had utilised their procurement organisations to make themselves stronger. These organisations had purposefully “influenced new spending areas and put in place new policies that were not possible before”. Furthermore 57% had brought additional attention, focus and resources to supply risk as an enterprise risk issue; and 53% added higher-value procurement ‘services’ to their service portfolio and increased their brand to the business. What more compelling evidence do CEOs and their CFOs need than those three statistics?

It was clear to me that from these austere times organisations are developing a new “normal”, one which takes account of increases in risk and volatility, where innovation is a prerequisite for survival and agility is key and supply side management according to the Hackett Group study is at the heart of it. But how many CEOs and CFOs realise this? How many of them realise that, to take a leaf from the Carlsberg marketing glossary, supply side management is *probably* their most important asset?

And yet the promise of the extended enterprise and interconnected collaborative networks has been talked about for years, way before the recession turned the spotlight on procurement. However few companies have achieved a level of consistent execution where the underlying practices of good supply management practice could be considered to be fully institutionalised.

The market success of the supply management “high flier” companies has been lionised in the business press—companies such as Dell, Wal-Mart, Apple and Toyota have become synonymous not only with supply chain leadership, but with flexibility, agility and cost effective

business practices; further- more virtually all best-in-class supply management organisations also provide superior shareholder return, better return on capital and shorter cycle times – the stuff of legend!

In today's cash strapped, hyper-competitive global economy, it is not surprising that these practices have caught the attention of senior executives and boards of directors across the spectrum of industries. The lure of optimised supply chain business benefits is seductive, especially to CEO's squeezed by eroding margins and accelerating pressures for top-line growth. For those who feel they have done all that they can do, does supply chain management loom as one of the most promising levers left to be pulled? I don't think it does.

The best-in-class supply management organisations mentioned above are held out as shining examples of supply chain excellence and they have all built their procurement infrastructures one step at a time, over a long period of time. Few executive boards in today's economy are interested in hearing about transformations which take years. For the most part, neither they, nor their share- holders have the patience for changes that go beyond one or two fiscal years. In an economic environment that rewards short term results, it is not surprising that as supply management organisations focused initial efforts on rationalising the supplier base, introducing spend management disciplines and obtaining price reductions, they felt amply rewarded for their efforts. The gratification was immediate, tangible and has powerful bottom-line impact.

As is often the case, the quick win can prove to be a double-edged sword. On the one hand, recent success and close focus has in many organisations gained Procurement a seat at the executive table of power and influence that had eluded most past generations of procurement professionals. They have been accorded visibility, clout and strategic muscle that, previously, would have been unimaginable. At the same time, these successes have also conditioned companies to anticipate an unending stream of continued short-term savings and bottom-line contribution. All the while, senior management is pointing to the examples of the supply management high-fliers, demanding to be more like them but acting like the old-school cost reducers they knew from days of yore.

The challenge for CEOs and CFOs alike is substantial. The organisational and individual competencies that produce such powerful results at the early stages of supply management transformation initiatives will not get organisations to the higher level rewards associated with the supply chain best practice organisations. One implication of the work CIPS has done in thinking about this so far is that doing more of the same, even with more resources, will not get organisations into supply chain heaven. While the core infrastructure of cost management disciplines is a critical building block for future success, many of the practices and competencies that serve an organisation well at the foundation levels, may actually conflict with practices and competencies required at the higher levels. Moreover theory and accepted practice have come some considerable way in the last two or three decades yet many organisations are still operating at a relatively unsophisticated level, and often by choice.

I believe to gain long term benefits chief executives of all denominations need to understand what is being termed the "New Normal" where agility is critical. It is no secret to anyone leading a business today that you exist in an increased climate of risk & volatility; one where globalization and emerging market exploitation requires an acceleration of, to use the business book lexicon, "creative destruction cycles". Organisations must use information and knowledge (via technology and people) to differentiate themselves in innovative ways. They must identify macro economic, social and other significant changes and interpret them into

the context of their specific organisation. They must identify the internal stakeholders and their input into the optimum, direction, shape, strategy and plan. This should naturally include a view from supply management professionals; put simply organisations must - innovate or die!

So as we come out of the recession, organisations in most sectors will be preparing for lower growth scenarios; and as I have already said, business support functions need to adapt to this new reality. One in which organisations are moving from siloed, multi-national operating models to truly global business operations and as a consequence their G&A “service delivery models” need to be redesigned accordingly. I guess what I am driving at here is that we should be aware that no one should expect a 21st century organisation, confronting 21st century problems to be satisfied with processes and systems developed decades ago.

According to a McKinsey’s study roughly half of the accelerated cost cuts made during 2008 – 2009 are likely to be permanent. The associated jobs that were eliminated aren’t coming back –and if or when they do, they’ll be increasingly contingent and almost certainly offshored. After an acceleration of G&A cost cuts in 2008 and 2009 triggered by unprecedented revenue declines during the recession, organisations are likely to revert back to the longer term historical trend of 1- 2% G&A cost takeout. Even organisations that made unsustainable cuts are rethinking not just their cost levels, but also how to create a more variable cost structure to be able to respond more quickly to increasing external volatility.

The future is based around a structure where Strategic Alignment is the glue holding together three specific pieces – value, performance and capability or what do we aspire to; what performance level is required for efficiency, productivity and effectiveness; and who’ve we got or who do we need to achieve this?

Let’s think for a moment about *your* next supply chain? As already mentioned new forces and dynamics are emerging to influence future Supply Chain design. If we look back the trends are easy to spot; the ‘80s was about the demands of just-in-time; in the ‘90s it was all about outsourcing; in the 2000s thus far it’s been the emergence of the internet. But what will be next? If the MIT Sloane Management Review winter 2010 is to be believed then there are six forces driving supply chain design.

Globalisation: an old force I know but one which will continue to develop producing longer and longer lead times and demanding the constant attention of the CEO;

Increasing logistics costs: In the last 5 years transportation costs have increased by 50% due to rising energy prices and Inventory increased by more than 60% between 2002 and 2008;

Increased levels of risk: The consequential “wicked problems” of embracing strategies such as lean manufacturing, outsourcing and offshoring;

Rising labour costs: Low cost countries were only ever a one hit. Globalisation has been happening for some 20 years... on my trip to China I was reliably informed that in the last 5 years local labour costs have increased on average by 20% year on year;

The focus on Sustainability: once considered to be a fad, we are now in a Europe which leads the world in developing green supply chains. In the UK legislation is being developed now regarding this: the Carbon Bill, the Equalities Act and the Remedies Act will all impact directly your supply chains;

The increasing volatility of commodity prices: potentially fatal for some organisations. Think airlines procuring fuel - do you go long or short term? How do you out guess the market?

Let's revisit risk for a moment, and my phrase "wicked problems". Whilst 'sourcing dreams' are obvious, think bottom line improvements, new capabilities, access to markets mainly developed in the '90s off-shoring boom – all very nice. But it's the 'sourcing nightmares' which keep CEOs awake at night. The damage a bad supply manager can do might well be catastrophic to your enterprise and here are a few salient reminders:

Poor Quality in August 2010, Toyota re-called over 8 million cars globally because of design and manufacturing faults in their cruise control and breaking systems. This led to huge costs, at least one high-profile class action lawsuit in California and the attention of the world's press.

Reputational Damage recently Primark the clothing retailer, suffered an attack on its reputation due to accusations of loss of control over its Indian based supply chain. Investigators uncovered the illegal use of child labour in the manufacture of its garments.

Corporate and Personal Liabilities in 2006, high-profile consumer electronic brands Dell, Apple, Lenovo, Toshiba Gateway and Fujitsu recalled around 10 million laptop computers containing Sony batteries after they were found to catch fire .

For CEOs the price of failure in their supply chains can be more than just their jobs! I am fast coming to the conclusion that at CIPS our focus should be on developing knowledge, guidance and products and services around this new normal. We need as a result of the recession to make CEOs aware of the fact that there is a wider breadth of offerings for their organisations developed specifically for them and their organisation.

Moreover their major expectation of their CPO should be to identify which impacts or activities are most relevant to the strategy of the organisation and make this known at the strategic planning stage. Once a corporate strategy is agreed, then a relevant procurement strategy can be agreed and appropriate capability developed and put in place to support it.

This broader remit even when tailored to specific organisations is likely to require a range of people with different skills to deliver it. The team structure and competency will depend on what specific value from the supply side is agreed with the organisations' leadership.

I would like to throw out a challenge to CEOs and CFOs alike and ask them to take a couple of minutes to fill out the questionnaire below in which they can assess how they rate their supply function against the criteria listed in it. A recent CIPS study highlighted that many organizations lack clarity regarding the strategic contribution they seek from procurement, and many senior executives neither see nor aspire to see purchasing and supply in a leadership role. We believe this to be a mistake and a lack of foresight on their part.

So, how do your actions in your organisation make your procurement function and the broader enterprise stronger, more agile and better able to weather future challenges?

Please allocate 100 points across all characteristics in order to reveal your "natural" style (column A). Then consider whether this has changed with the recession (column B) and whether it would change again once a significant recovery was under way (column C).

Adapted from Sawchuk 2010

	Factor	Characteristics	A	B	C
1	Capability	Does your procurement team add high-value procurement services and related capabilities to your service portfolio?			
2	Foresight	How much do you think about the leadership and management of your procurement processes as services?			
3	Measurement	Are you adding higher-value metrics to your scorecard for supply side management and gaining associated resources?			
4	Risk Management	Does your procurement function help the enterprise become more agile through better commercial risk management and improved variability of asset/cost structures?			
5	Agility	Are you making Procurement/Supply Side management more agile to deliver more capacity and savings?			
6	Resource Management	Are you extricating procurement staff from low-value processes and obtaining maximum value (and minimizing distractions and risk) in P2P?			
7	SRM	As the economic recovery continues, what will your suppliers do? Innovate with you...or retaliate?			
			100	100	10

The final point I would like to make comes from a colleague and an academic who has worked for a long time with the Institute, Professor Martin Christopher: “The opportunities for cost reduction are finite – there are only 100 cents in every dollar. However, the opportunities for enhancing customer value are infinite – we are only limited by our imagination”.

Gerard Chick: Head of Research & Knowledge Management July 2011

CIPS Group Easton House, Easton on the Hill, Stamford, Lincolnshire, PE9 3NZ, United Kingdom
T +44 (0)1780 756777 F +44 (0)1780 751610 E info@cips.org

CIPS Africa Ground Floor, Building B, 48 Sovereign Drive, Route 21 Corporate Park, Irene X30, Centurion, Pretoria, South Africa
T +27 (0)12 345 6177 F +27 (0)12 345 3309 E infosaf@cips.org.za

CIPS Australasia Level 8, 520 Collins Street, Melbourne, Victoria 3000, Australia
T 1300 765 142/+61 (0)3 9629 6000 F 1300 765 143/+61 (0)3 9620 5488 E info@cipsa.com.au

CIPS Middle East & North Africa Office 1703, The Fairmont Hotel, Sheikh Zayed Road, PO Box 49042, Dubai, United Arab Emirates
T +971 (0)4 327 7348 F +971 (0)4 332 5541 E mena.enquiries@cips.org



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