

VALUE FOCUSED SUPPLY: Linking Supply to Business Strategies

By Robert Monczka, John Blascovich, Leslie Parker, and Tom Slaight

Over the past two decades, companies worldwide have saved hundreds of billions of dollars by aggressively applying competitive sourcing techniques to their spend base. Companies gained control over 50, 60, or even 70 percent of their revenue that flowed to suppliers. Information technology enabled companies to gain visibility into what they were spending, where, and with which suppliers.

By spend aggregation across business units and geographies and concentrating spend with fewer suppliers, companies established leverage they never realized they had. Standardized approaches to sourcing brought rigor and discipline to both fact-finding and analysis. E-tools enhanced competition, improved decision-making, and sped up sourcing processes.

Looking back over the past 20 years, it is clear that competitive sourcing created significant value for companies by driving major cost savings directly to the bottom line. However, A.T. Kearney's 2008 *Assessment of Excellence in Procurement (AEP)* global research


found that the savings gap between "leader" and "follower" companies had shrunk by half just since 2004. Continued attention to competitive sourcing will remain necessary just to keep up.

Value derived from sourcing cost savings will not be enough in the coming years. Even before the economic crisis of 2007-2009, CEO expectations for supply had expanded well beyond cost reduction to include innovation and growth, risk management, value chain optimization, and even sustainability.

Since the crisis, macroeconomic forces and competitive conditions have created an even more turbulent and uncertain business environment. Competition has intensified because of slower overall growth and restrained, less trusting customers are redefining what they value. Increased government power is placing new regulations on how businesses will operate. Greater government borrowing may portend higher taxes, greater currency fluctuations, higher interest rates in the commercial sector, and uncertainty regarding deflation/inflation direction. Growing demographic pressures are affecting consumer buying patterns. Workforce size is changing in developed and developing countries. In combination, these forces will have a direct impact on how tomorrow's value chains are structured and how they operate.

In this environment, just saving money on external expenditures will not be enough to survive, let alone thrive, in the years to come. Companies must find and obtain additional value from their supply relationships. The supply network needs to contribute holistically to the company via innovation and growth, asset utilization, sustainability, risk management, and overall competitiveness

Dr. Robert M. Monczka (rmm@monczka.com) is Director-Strategic Sourcing and Supply Chain Strategy, CAPS Research, and Research Professor, Supply Chain Management at the W.P. Carey School of Business, Arizona State University. John D. Blascovich (john.blascovich@atkearney.com) and Tom Slaight (tom.slaight@atkearney.com) both are Vice Presidents and Partners with A.T. Kearney. Leslie M. Parker is a Principal with A.T. Kearney. She can be reached at leslie.parker@atkearney.com.



The ongoing pressure to cut sourcing and procurement costs is certainly understandable. But simply saving money on external spend will no longer be enough to survive, let alone prosper, in the years ahead. What's needed instead is a new, longer-term approach that closely links supply management with business strategies. We call this breakthrough technique

Value Focused Supply.

as well as cost.

These new, more advanced Value Focused Supply (VFS) strategies are the target of this article, which is based on the research project conducted by CAPS Research and A.T. Kearney described in the accompanying sidebar. The aim is to understand how a holistic value approach differs from traditional competitive sourcing approaches, examining the changes required to areas such as company and supply philosophy, value goals and metrics, sourcing and supplier management approaches, and internal and external teaming for the company's strategic purchases. It also examines the type and degree of C-level executive involvement, understanding, and support needed to ensure tighter linkage between business strategy and supply and deeper cross-functional collaboration.

Defining Value Focused Supply

At its core, Value Focused Supply is an approach for creating and implementing longer term strategies for key categories and their suppliers that go far beyond competitive sourcing. By linking supply to competitive business strategies, the goal is to increase the attractiveness and competitiveness of the company's end products and services, thereby increasing value for both customers and the company. Ideally, VFS starts with a deep understanding of what customers (both consumers and end users) value, then maps that understanding backwards through the company's part of the value chain and outward to the supply base, through multiple tiers. This helps to isolate those categories that are critical to driving value in the end markets and allows the company to focus on shaping and using the capabilities of the supply base to complement and supplement its own—and in turn create more value for the customer and the company.

Value Focused Supply Strategies

The best way to illustrate the breadth, depth, and impact of VFS strategies is to examine the wide variety of examples

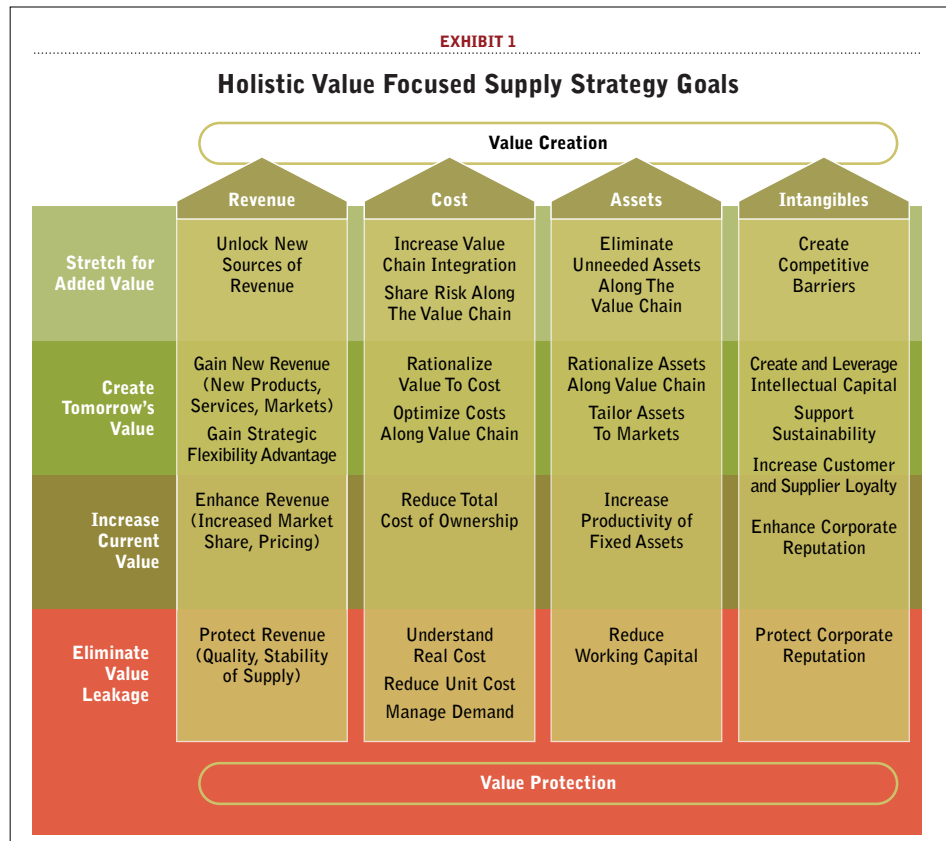
found in this research. We found that value was created in four increasingly sophisticated ways—eliminate value leakage, increase current value, create tomorrow's value, stretch for added value—as illustrated Exhibit 1.

Eliminate Value Leakage

The first level of value that VFS can provide is to ensure that value is not being lost from a key category. On the revenue side, revenue must be protected by providing quality, cost availability, lead-time stability, and predictability for goods and services purchased.

To illustrate, Powercon (one of the participating companies in our research—all names disguised) found that it had to eliminate value leakage from a key electronics category. Specifically, poor delivery performance by a sole supplier for a segment of the category caused the company to delay shipments, which in turn affected customer service levels and made for unsatisfied customers. The company undertook a formal effort to explore improvement options by assembling a cross-functional team that included an expert in lean, Six Sigma, and quality and manufacturing functions.

As part of this initiative, Powercon dispatched a lean, Six Sigma expert to spend three weeks at the supplier's plant in Asia to identify potential improvements. The



expert examined setup, changeover, equipment, planning parameters, minimum order quantities, inventory, and transit. Among the key findings, the expert discovered that the supplier had reduced its on-hand inventories and was only shipping once per week. To help set the course for improvement, the expert suggested some operational changes intended to increase on-time delivery performance to 98 percent. The recommendations included new safety stock rules, increased levels of on-hand inventory, twice-weekly shipments, adjusted minimum order quantity rules, and increased supplier-managed inventory levels at the supplier's own component suppliers.

Powercon found that poor delivery performance not only affected the revenue side but also caused spill-over problems: production inefficiencies due to rescheduling around the shortages; increased inventory levels to buffer against shortages; and increased costs to track and expedite shipments from the supplier. By fixing the delivery problem, the company also found that it needed less inventory throughout its operations. Reducing inventory investments and costs allowed for better pricing to customers. Learnings were also transferred to other suppliers, leading to improvements in their performance. Customer loyalty improved due to improved order reliability. In addition, the company gained increased flexibility in manufacturing, allowing it to respond more quickly to customer order changes.

Value leakage from cost often results from non-competitive unit costs or ineffective demand and consumption management. Traditional actions associated with competitive sourcing, such as reducing the number of suppliers, leveraging company-wide volumes and soliciting new bids, help to ensure that the company receives pricing (unit cost) that is competitive in the market. Rationalizing specifications and controlling consumption also helps to eliminate unnecessary expenditures.

Another source of value leakage is working capital. Negotiating appropriate payment terms with suppliers—and then taking advantage of these payment terms—helps keep cash on the books. Working with suppliers that provide quality parts and assemblies with reliable delivery helps to minimize rework, inventories of rejected items, safety stock inventories of usable items, and work-in-progress inventories of products that use the items.

Increase Current Value

From a Value Focused Supply perspective, actions to prevent value leakage are largely defensive. While this type of defensive stance is important, it does not actually create new value. Instead, as the companies participating in our research have demonstrated, value creation

begins by adding to revenue, attacking costs broadly rather than on a unit-price basis, making better use of fixed assets as well as working capital, and improving the company's image in the eyes of customers. There's an important difference between preventing value leakage and creating value. Actions to prevent value leakage are more prescriptive and generally applicable across the entire spend base. Actions to create value, on the other hand, are more dependent on the specific category situation and often require specialized knowledge and skills as well as a higher degree of insight and creativity.

Increasing market share or improving pricing on existing products and services can increase revenue and current value. By creating an alternative source of supply for a severely constrained component, Bentham captured the lion's share of the market from its competitors, while also commanding premium pricing. Healthfoods, another of our research participants, was able to enhance market share in emerging markets by using supplier market intelligence to develop products that fit local customer tastes.

Create Tomorrow's Value

In addition to creating value based on today's set of products and services, VFS can be used to recast how both the company and its suppliers create value in the future. This includes actions like leveraging supplier knowledge and insights to identify consumer and end user marketplace needs to help create unique value for these markets. Another would be to take advantage of the supply base's technology capabilities to gain competitive advantage in new product and service design and lead time.

Several participating companies found ways to gain new revenues by working with suppliers of key categories to develop and introduce new products and services and enter new markets. By developing a new alloy with its supplier, Bigtru was able to introduce a new form of engine part that provided comparable performance at a far lower cost for today's autos. Not only did this increase market share, the new alloy positioned the part for significant future growth as the auto industry's engine technology evolved. Additionally, the company gained a strategic lead-time advantage of as much as three years over its competitors.

There are several ways to create value for tomorrow in terms of cost. Improving the value-to-cost ratio by techniques such as value engineering (for new designs) and value analysis (for existing ones) helps companies strip out unnecessary cost and get more "bang for the buck" from purchased goods and services. Optimizing value chain cost includes rooting out waste at any stage of value add, as well as reassigning work along the chain

to improve overall efficiency.

F&B combined several approaches to create a value-focused strategy for a key commodity. It simplified product specifications and found ways to reduce usage of a key ingredient. It also assigned volumes to suppliers based on the fit with each supplier's "sweet spot" of capabilities. In some cases, this allowed suppliers to exit businesses that did not fit well, helping them become more efficient. F&B also developed in-house capabilities to process/manufacture certain ingredients to increase its knowledge of the processes in use by suppliers. Overall savings from the effort totaled 12 percent.

Companies can create value for the future by working with suppliers to rationalize/optimize the asset structure across the value chain. Steps that can be taken in this regard include eliminating duplicate assets, outsourcing or in-sourcing assets to achieve scale or cost advantages, and repositioning assets geographically to match market needs or to mitigate risk.

Healthfoods was projecting rapid growth in emerging geographic markets. It needed a supply strategy for its capital equipment that would support both a dramatic rate of growth and the unique requirements of its developing markets, which were trending toward increased product diversity, coupled with lower volumes of sales on individual products. Healthfoods was already expanding its use of developing-country supply markets for capital equipment as a way to reduce costs in mature markets. So it piggybacked on this effort and worked with those same suppliers to design and make equipment suited for the local market. The company was able to cut the time needed to introduce a new product in a new location by almost 25 percent. Further, it found that the local suppliers provided knowledge of local consumer preferences that helped to improve product formulations and guide sourcing for raw materials best suited for those formulations.

Stretch for Additional Value

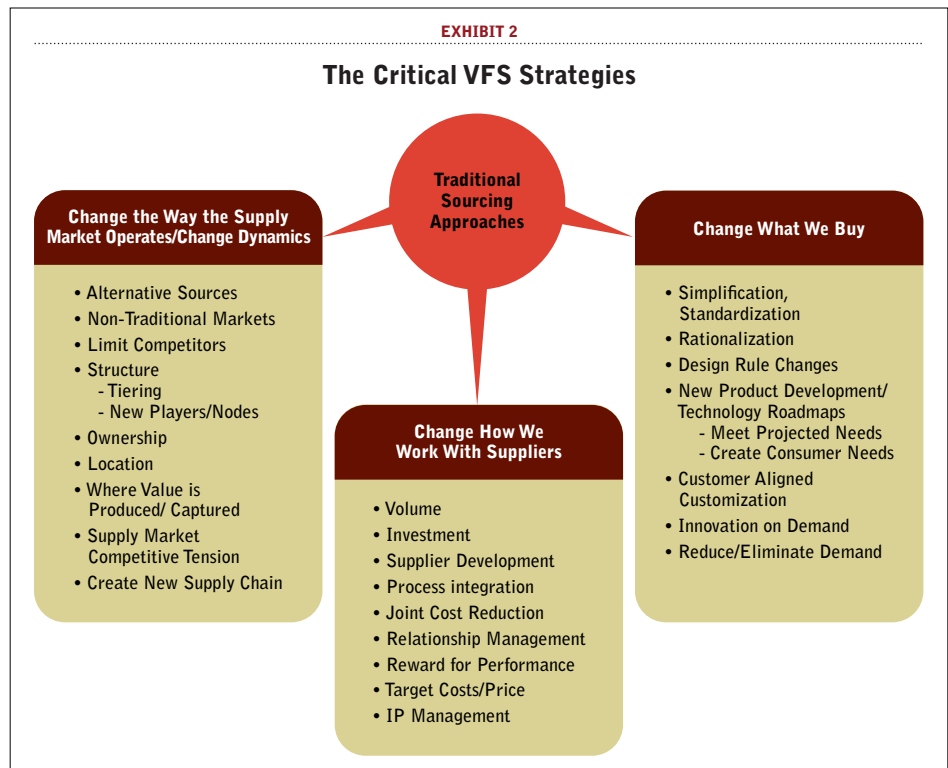
As the previous examples illustrate, our research surfaced several instances of companies using both traditional and innovative approaches to increase value from key categories. We also found that a few study participants stretched the bounds of conventional category management and found

entirely new ways to create, shape, and use supply markets to generate value and competitive advantage.

Stretching for revenue sometimes means completely reshaping the supply market to unlock barriers to revenue. It can also include finding creative ways to leverage the company's value to the supplier—and to turn that into a source of revenue.

Bentham, for example, was missing out on a boom time in a major customer market. Growing demand for its customers' end products plus rising prices for raw materials left customers clamoring for new plants and equipment that could process a cheaper but less pure grade of raw material. A bottleneck for a key component used in raw materials processing created by a near-monopolistic supplier and three-year backlogs was making it difficult to compete for future business.

Unprecedented market demand had created a window of opportunity for Bentham to make a bold move. The company decided that its best chance was to bypass the traditional supply market for the component and to develop a new captive source that it would be able to strongly influence. Bentham found alternative sources for steel and fabrication and built a supply chain that delivered the components in half the time. The company used the availability of the component from this new source of supply as a point of differentiation in its sales efforts. Faster construction of facilities with this component meant that customers could generate revenue sooner and free funds that would



otherwise be tied up in construction. As a result, the company successfully won a series of contracts and generated substantial incremental revenues and profits.

Lastly, a company can obtain additional intangible value by including approaches that are difficult to copy by competitors in its supply strategy for critical categories. Bentham did more than just set up a successful alternative supply chain for the key component. It also negotiated capacity arrangements with the only practical alternatives for steel supply, which effectively made it more difficult for competitors to set up competing supply chains.

Some Observations on Value

As the examples above indicate, value can take on different forms according to the company situation, the category involved, and the supply market opportunities or limitations. For some, value comes from a broad supply market value strategy aimed at influencing or even reshaping whole supply markets. In other cases, it involves value-focused sourcing strategies aimed at extracting available value from the market, ranging from better pricing to gaining equity stakes in suppliers in exchange for the value the company generates for the supplier. In other cases still, it involves strategies centered on collaborating with specific suppliers of key categories to unlock even more value.

It's important to note, too, that individual value-focused category strategies are often multidimensional in terms of the value that they generate. Several examples drive the top line and the bottom line simultaneously, and some even have spinoff benefits related to assets or intangibles.

Finally, a clear pattern emerged from our research. The more sophisticated a VFS approach, the stronger the linkage required between the company, business unit and product line strategies, and the underlying category strategies. In turn, this means that the category strategies are more directly linked with what the consumer or end user values as well. See Exhibit 2 for an overview of critical VFS strategies.

Where to Start with Value Focused Supply?

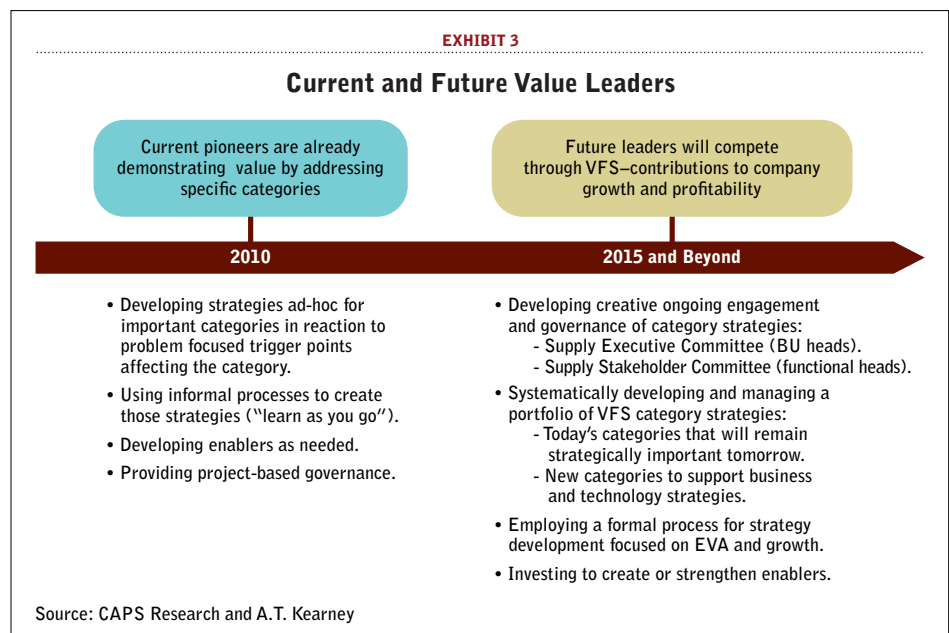
In this research, many of our examples show VFS

applied as a result of “trigger points”—that is, specific category issues or even crises—that required attention to protect or create value. Enablers were developed on an “as needed” basis to overcome the crisis or respond to the trigger. VFS strategies were not regularly applied on an ongoing basis, as illustrated on the left side (2010) of Exhibit 3.

For the future, leading companies will need to systematically develop supply strategies and their enablers highlighted above to meet both current and future strategic needs. In order to identify, predict, and respond to those needs, an ongoing organization should be developed to guide the company to compete through VFS, as depicted on the right side of the exhibit (2015 and beyond). As an initial step, a supply stakeholder committee that is influenced but not led by supply management may be formed. This stakeholder group will provide insight and resources to support individual VFS initiatives.

Longer term, the company might form a supply executive committee (comparable to a marketing or finance executive committee) to orchestrate the development and implementation of the company's portfolio of VFS strategies. This committee would be led by a senior executive and supported by other functional executives, including supply management.

Applying VFS systematically requires a fundamental shift in the way that many stakeholders approach supplier relationships. Rather than viewing individual suppliers as their own responsibility with supply management tasked with identifying qualified alternatives and competitive pricing, stakeholders need to view the supply base as a corporate resource that can help meet the company's



strategic needs much in the same way that marketing, financial, or technology resources are identified and deployed.

Two natural questions given this ambitious objective would be: “Where should I start?” and “Is this a push or a pull effort?” Undertaking this type of mission requires a sensitive balance between supply demonstrating that

it has the capability to provide unqualified leadership in managing the supply base as a critical corporate resource, on par with finance and marketing, and promoting the request to create the role by a trusting senior management. Making senior management aware of the value of such a mission without seeming self-serving becomes the challenge.

Details on the Research

This major research initiative of CAPS Research and A.T. Kearney identified four objectives:

- Establish how value is being created for strategic purchases through Value Focused Supply strategies.
- Define, establish, and communicate overall approaches and capabilities that enable development of VFS.
- Demonstrate application of VFS through practical company case examples.
- Enhance the understanding of C-level executives about how VFS strategies contributes to sustainable business and product/service competitive advantage.

Fifteen companies with VFS experience agreed to participate in the case-based research (see accompanying exhibit—company names disguised). These companies represented a wide variety of industries including aerospace and defense, automotive (OEM and supplier), consumer durables, consumer packaged goods, engineering, procurement and construction (EPC), health care delivery, high tech, industrial control systems, media and entertainment, pharmaceuticals, and raw materials processing. Individual company revenues ranged from \$4.5 billion to more than \$100 billion, with combined revenues for the 15 companies exceeding \$500 billion. Typically, these companies were among the top three within their industries in terms of reputation.

Our approach involved looking at VFS from both a bottom-up and top-down perspective within a company.

Specifically, we sought to:

- Gain an in-depth understanding of how a company approached VFS for one of its strategic categories (a “case study example”).
- Profile how the company had extended VFS across its portfolio of key categories (the “company narrative”) and the degree to which the approach was formalized.
- Gain additional insights from review and discussion of the preliminary findings in a full-day conference with the study participants.

Participating Companies

Company (disguised)	Industry Group	Value “headline”
Apollo	Media and entertainment	New packaging sets industry standard—boosts sales.
Bentham	Engineering, procurement, and construction	Creates new supply chain—bypasses chokepoint, boosts sales.
Bigtru Co.	Automotive supplier	With supplier co-develops new alloy, gets head start for future products.
Carco, Inc.	Automotive OEM	Novel approach to tooling cuts costs throughout the value chain.
ComCo, Inc.	Power systems	Embraces cross-functional supply approach for next-generation products.
Duraman, Co.	Consumer durables	Engineering-procurement collaboration chops product complexity and cost.
F&B, Inc.	Consumer packaged goods	Company and suppliers align resources with what consumers value.
Globalgoods	Consumer packaged goods	Finds novel ways to share in increased supplier value.
Healthfoods, Inc.	Consumer packaged goods	Supply strategies help drive developing market growth.
HiTech, Inc.	High tech	Collaboration on component design yields one-year lead over competition.
Meditrend	Health care delivery	Cross-functional cooperation maps the way to improved patient outcomes.
Metropolitan, Inc.	Raw materials processing	Spec changes, market intelligence, analytical tools create supply flexibility.
Pharmacare	Pharmaceuticals	Supply management unlocks value in “sacred cow” category.
Powercon Co.	Industrial control systems	Corrective measures stop value leakage at supplier.
Techco, Inc.	High tech	Supplier collaboration boosts quality, cuts cycle times and costs.

Source: CAPS Research and A.T. Kearney

Senior Management's Role in VFS

What do the companies in our research tell us about the involvement of senior management and of senior executives in other functional departments? In some instances senior management sponsored the VFS projects and program, and organized the multidisciplinary group in which supply management played a key role. In other cases, related functional departments—be they finance, engineering, legal, manufacturing, or product development—played a partner role with supply management to promote VFS. In only a few of the research cases did the supply management function drive the VFS idea by itself.

At four of the companies, top management sponsored broad-ranging initiatives focused on capturing value that included supply management as a key contributor to the process. Multifunctional, multiunit teams were established to spearhead the approaches. In addition, these teams addressed specific supply categories to protect or create value.

For three other companies—Bentham, Bigtru, and Carco—top management recognized the threat or opportunity posed by a specific supply category and then sponsored and resourced multi-disciplinary teams to seek VFS opportunities. At Bentham, systemic barriers were overcome to open up a promising revenue-producing opportunity. At other companies, supply management obtained support from other functional areas to protect or create Value Focused Supply. At Apollo, for example, collaboration between packaging design, marketing, and suppliers enabled the establishment of an industry standard for a new product package.

In all of these instances, trigger points drove the development of either a broad-based program driven by threats and opportunities outside of supply management or an opportunity for a few functions to collaborate with supply management to address Value Focused Supply. We did not see a well-established, systematic approach to VFS of the sort portrayed on the right side of Exhibit 3. What would be required to set up such a program?

A Supply Management Mission Statement

Let's say that a company has been able to establish a supply executive committee as a systematic organization to address Value Focused Supply. The committee seeks to develop a supply management mission statement that incorporates the principles of VFS. What would that mission statement look like? We believe that it would include the breadth of vision, understanding of the main value components and capabilities needed to be a key

player in VFS endeavors.

We will suppose that the following mission statement is adopted:

"Our mission is to create or enable the supply needed to meet our company's strategic goals. This includes, but is not limited to, the following objectives:

- *Mission—Lead a powerful global force, **mobilizing scale and innovation** to support our company's strategic objectives, instead of just relying on individual efforts to meet cost reduction targets.*

- *Mission—Be the **go-to people** for knowledge of the source and use of strategic value for each existing or future spend category at our company.*

- *Mission—Be the **leader, influencer, or participant** in the creation of leading-edge, innovative value-focused strategies for strategic purchases.*

- *Mission—Be the **trusted provider** of knowledge as well as of the implications of strategic risk for each existing or future spend category at our company.*

- *Mission—Be the **accomplished team** recognized as playing a key role in our company's success, and as a great place to build a career, instead of a set of disparate units with pockets of strength.*

- *Mission—Be the **collaborative and information connection** between our customers, other company functions and our suppliers to map value creation and implementation, instead of just a contributor to the efforts of others.*

By fulfilling this mission, supply will become a key resource to meet our company's strategic objectives, along with other elements such as financial resources, human talent, technological assets, and market strength."

Can your company become a leader in Value Focused Supply? As a supply management executive, can your supply management organization become known for VFS within your company and its supplier community? As a supply management professional, can you lead the development of your own skills and capabilities for that kind of a reputation?

Overall, leading companies will increasingly view strategic suppliers as extensions of their organizations and tap into supplier resources and capabilities to jointly protect and create value. Companies that lead in the implementation of Value Focused Supply have the opportunity to achieve breakthroughs in value creation—leveraging the functional expertise across the organization—that informs and supports the company's strategic goals. ☺☺