

Strategic Supply Management – A Growing Source of Competitive Differentiation

a report by

Andy Eversbusch and **Rolf Schimrock**

Vice President and Principal, A.T. Kearney, Inc.

Strategic supply management will soon be influenced by a number of powerful forces. Unreasonable customer demands, quantum advances in technology, heightened economic challenges and enhanced risks to business continuity are collectively bringing waves of change that will severely test traditional approaches to strategic supply management.

The good news is that these future forces offer great opportunity to elevate the procurement function's role through strategic supply management. A proactive approach will allow companies to take advantage of increased opportunities and expectations in value capture and value creation. At the same time, supply management will lead, or at least catalyse, integration within and across supply chains.

Procurement leaders will need to remain abreast of strategic changes while keeping sight of the execution of well-known strategies. In this new era, the winners will be those that can adapt to radical changes while continuing to effectively bring about incremental improvements.

The Impact of Future Forces

A number of future forces will have a major impact on strategic supply management. Individually, each may appear manageable; collectively, they sound an urgent call for procurement leaders to rethink core strategies and take bold action while maintaining a focus on existing strategies.

Technological change will continue to bring about radical change in certain industries and is likely to impact multiple facets of every value chain. Photo imaging offers a good case in point. Over the past decade, the development and rapid adoption of digital photography has had an impact on the types of products being made, as well as the participants in the value chain. The purchasing pattern has shifted. Where the photo processing market was long dominated by laboratories that purchased chemicals and light-sensitive paper, there is now a sizeable market of home users who buy glossy paper and printer ink, circumventing the traditional process.

Future manufacturing capabilities and product design will change how companies purchase. Consider the impact of products such as 'printable' bicycles, which are tailored to a specific individual's size and design preferences, then manufactured using two-dimensional designs on water jet cutters. Such technology could change supplier economics and impact their own manufacturing plants along with the related supply lines supporting them – not unlike the impact that mini-mills have had on the steel industry.

Customer expectations will continue to grow. Increasingly, customers seem to want it all: superior value for price, highly customised products and services, and flawless life-cycle service. This combination will place radically different demands on operations. Vastly increasing volumes of orders in decreasing order quantities will greatly affect distribution patterns and dramatically change the role of suppliers.

World economic and geopolitical changes compound these challenges. Increasingly, companies have to understand and attempt to anticipate the future direction and pace of globalisation, the impact of social forces, changes in business regulation and the potential impact of global security threats. These forces will deeply affect strategic supply management. Companies have a growing need to re-evaluate how their products sold will differ by region, where supply sources must be located and what local requirements must be met.

Capturing the New Opportunities

To respond to the changing environment, chief procurement officers (CPOs) will need to extend beyond their current capabilities to define and execute a new, compelling strategic supply management vision. Living up to this new vision will require that procurement leaders do the following:

- define breakthrough strategic supply management strategies;
- exploit changes in the business environment; and
- focus on relentless execution.



Each individual company's preparedness to perform these tasks varies, but failure to do so will significantly detract from their chances of future success.

Define Breakthrough Strategic Supply Management Strategies

Chief procurement officers will need to identify the next levers of value capture and value creation throughout the value chain, including all existing and potential value chain components. Examples where this applies include the successful transition of supply bases to emerging markets with lower labour rates (for example fabrication and machining components), pursuit of more integrated solutions to structural cost problems (for example airline maintenance and repair operations) and more effective leverage of capabilities from all partners in the value chain (for example automotive design, manufacturing and assembly).

Another priority in setting strategies will be a renewed focus on a company's core competencies. This may require outsourcing non-core processes and shifting activities to an industry leader with both the scale and expertise to reduce cost. The recent wave of companies outsourcing their maintenance, repair and operations procurement illustrates this trend. A second area of growing relevance is contract manufacturing. The emergence of the electronics contract manufacturing industry over the past 10 years will likely be imitated in other industries.

Market intelligence will be another key component. A leading global technology firm surpassed its competitors when it created an advantage three levels back in its supply chain by locking in the supplier of a critical component. Best practices in obtaining market intelligence today require leveraging dramatic improvements in information availability, broadening the understanding of the supplier market to a global level and deepening the understanding of core suppliers.

Exploit Changes in the Business Environment

The business environment is changing, but companies must be willing and able to exploit these changes in order to survive and prosper. To meet ever-increasing customer demands, companies will need to align supply capabilities proactively by transferring some of these demands to suppliers – essentially requiring suppliers to contribute to and support a more efficient value chain. One company rising to this challenge is Frog Design, which demonstrates its understanding of customer needs through its product design collaborations with clients as varied as Apple Computers, Disney Cruise Lines

and Ford. Companies will also be challenged to quantify their value-add to customers in order to enable value engineering-type projects.

With the rapid pace and multitude of technology changes, companies will need to seek out and capitalise on technology innovation with their suppliers. In addition, there is a continuous need to anticipate the implications of radically new technologies on businesses, products, processes and geographies. A clear e-supply management strategy that leverages the combined power across all core business processes impacted by procurement (e-design collaboration, e-sourcing, e-category management, e-transaction processing and an e-powered collaborative supply chain) is the starting point for effective technology leverage for buyers and suppliers alike.

Finally, in order to face economic and geopolitical shifts, companies will have to consistently monitor how supply strategies address world economy pressures and create contingency plans for high-risk markets. For example, one consumer products company had to re-examine its supply chain to fuel growth. Finding the local cost of a crucial ingredient so high that it posed a barrier to its European market entry strategy, the company extensively examined raw material prices and supplier processing costs. It then worked with suppliers to obtain raw materials, and helped processors improve their own manufacturing process to reduce costs. Doing so allowed the company to make a successful entrance into this new market.

Focus on Relentless Execution

While these changes will require a great deal of attention from procurement chiefs, they must not distract them from their most important priority: a relentless focus on flawless execution. Several components are crucial to achieving this, beginning with the quest to attain 'perfect information'. Knowledge is a strategic asset, and companies need to continue to nurture and reward quality data and invest in the tools required for effective decision support. For example, one telecoms company has undergone a significant mindset change to stay abreast of the technology curve that is so crucial to its industry. To keep informed about new developments, the company has developed relationships with venture capitalists and next-generation technology firms, while adding resources dedicated to identifying, testing and integrating new technology. The upshot is that additional capacity and capability are added to the company's network ahead of its competitors.

Secondly, growth and innovation opportunities need

to be pursued and captured relentlessly, as the consumer products company cited previously did in entering the European market. Companies may have to look outside themselves to uncover sources of innovation, as Ford did in working with Frog Design on the interior of a new electric vehicle. Companies will need to better consider how suppliers can be leveraged for collaborative innovation and even for help generating revenues.

Supply management leaders will need to take cost reduction to the next level. New sources of value can be captured by working across functions such as engineering, research and development and marketing. Companies should pursue step-change cost reduction from sources like emerging markets, new process technology and asset reconfiguration while driving supplier development and integration. For example, General Mills, which uses egg whites for many products, teamed up with a noodle manufacturer, which only uses the yolks, to coordinate purchases from a single supplier. In collaborating on product specifications, they were able to lower the supplier's costs, with all three participants sharing the savings. General Mills also leveraged its grain purchasing experience to lower the egg supplier's cost for its most costly raw material, chicken feed, fuelling further savings for all three parties. As a result of the fact that cost-reduction opportunities are greatest in the conceptual design and detailed design life-cycle stages, next-level cost reduction will require early life-cycle involvement by all pertinent parties.

A step-change approach to cost reduction has proved successful for many companies in the automotive industry. Design and specification changes have led to an additional 25% improvement in cost reduction, above and beyond that attained through supplier process and price improvement efforts. Furthermore, joint efforts of purchasing and engineering resulted in an additional average cost saving of 10%, doubling the increase attained through independent efforts undertaken by the two functions.

A Turning Point for Supply Management – Lessons Learned From the IT Function's Experience

Purchasing now faces a turning point strongly akin to the situation that faced information technology (IT) departments just two decades ago. In the 1970s and early 1980s, the broad availability of computing power held great promise even as it created enormous competitive risks. At the time, IT was viewed as a significant competitive weapon; time has

proved that this was not true for all companies.

Ultimately, the IT function evolved to pursue three main models. The first, which was widely predicted, saw IT become a customer-facing strategic differentiator. IT executives became chief information officers, and leading companies used IT as a competitive weapon. At other companies, IT came to be valued for its reliability and employed mainly as a support tool. In a third, largely unexpected development, companies decided that IT was not their core competency and allowed specialised outsourcing companies to manage and provide these services. Today, leaders in IT management are those that best know how to apply all three models.

For IT, the trigger point was the personal computer as small-scale computing came to strip away much of the mystique from data processing. For purchasing and supply management, the Internet has been this trigger. Previously, the supply market was a realm that could only be accessed by diligent practitioners working in offices crammed with supplier catalogues. Now, the supply marketplace has an electronic billboard online that faces the world – an interface available to everyone, not just the purchasing agent. Companies now want virtually all goods and services to be sourced effectively, managed well and purchased efficiently.

Far from what we may expect in these early pioneering days of the Internet-purchasing interface, the supply models of the future are likely to parallel the evolution of the IT function. For procurement, a model similar to IT is likely to appear over the coming years. Leaders will evolve into 'strategic weapons' by providing customer-facing innovation and revenue and create strategic cost advantage under the leadership of a key executive. In other areas, a utility or shared services approach that manages for optimal efficiency and cost will be employed. Finally, it is likely that large portions of companies' buys will transition to an outsourced service that can capitalise on its own expertise and advantages of scale.

In summary, supply management will continue to face dramatic changes, but many of the fundamental drivers of value will remain the same. Leaders in supply management will be those that know how to turn these changes and threats into opportunities and capitalise on them for competitive advantage. The real challenge for CPOs will ultimately lie in finding and maintaining an effective balance between the necessary 'creative destruction' of today's practices and a relentless execution of proven approaches. ■