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Achieving Supply Chain Productivity

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Forget traditional supply chain management. Managers must be responsible for the earning power and productivity of the assets in their trust, not just cost control, argues Jonathan Byrnes.

by Jonathan Byrnes

What's the biggest problem in supply chain management today?

It is that all too often, the mission of the supply chain organization is defined much too narrowly. In most companies, many of the most important elements of supply chain management actually lie outside the supply chain organization. They are managed by other departments or, more often, not managed at all.

A few weeks ago, I reviewed a survey of the top managers of major company supply chain organizations. High on their lists of supply chain priorities were operational topics like improving supply chain visibility. When I saw this, I knew there was a problem.

Supply chain visibility certainly is a significant supply chain issue. Getting better information on inbound movements, customer stock, and store shelf inventory will lead to cost savings. But these potential improvements are incremental in nature, not paradigmatic change.

Think about this. In response to last month's column, I received an e-mail from a friend who has headed a major big-box retailer and a major grocery chain. He said, "The supermarket analysis was right on! That is, only 11 percent of our customers were profitable. What is utterly amazing is the number of stores that are not profitable, yet continue to operate."

What does this have to do with supply chain management? Everything!

Supply chain managers must be responsible for the earning power and productivity of the assets in their trust, not just for cost control of these assets. This is supply chain productivity, and it goes far beyond traditional supply chain management.

Supply chain productivity is essentially a ratio. The numerator represents the net profits generated by your supply chain assets. The denominator represents the assets, chiefly inventory, required to generate the profits. I described this in last month's column, "Precision Retailing." In most companies, this ratio, called the return on invested capital (ROIC), can be calculated on a PC for all customers and products with a few months' work. This shows the pattern of profitability of a company's supply chain assets, and the true performance of the company's supply chain.

If only 10-40 percent of a company's business is profitable, as my friend noted and as I've found in company after company, then a major block of the supply chain assets are unproductive. This is a huge supply chain problem, and a major opportunity for paradigmatic improvement. Yet how many supply chain managers see capitalizing on this opportunity as the most essential part of their job?

Think of it this way: If you work hard and achieve a 15 percent cost reduction on supply chain assets, and these assets are supporting unprofitable business, your job is not yet done.

In most companies, the fastest and most effective way to improve supply chain productivity is to change the mix of business being sold, so that it better fits what the company can supply. Not all revenues are equal. Some revenues will produce high profitability, and some revenues will actually degrade earnings. The differences are amazingly large in most companies. I've seen this consistently in over two decades of research and consulting in over two dozen industries.

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Yet virtually all sales compensation systems are driven by revenue maximization, or occasionally by gross profit maximization. This is the underlying cause of most poor supply chain productivity, and doing something about it nearly always is simply assumed to lie outside the supply chain organization.

Faced with this reality, supply chain managers have a choice. Either they can confine their efforts to traditional supply chain matters like product flow visibility and cost control, or they can step up to the broader opportunity of maximizing their asset productivity. If they choose the latter, it will sometimes involve cost minimization, sometimes changing revenue streams, and sometimes actually increasing costs to obtain disproportional revenue increases.

However, it will always involve working intensively with counterparts across organizational boundaries to jointly create important new value.

In my discussions with supply chain executives, I have found that what they are really most concerned about is playing an important role in the strategy and direction of the business.

All too often, supply chain managers feel that supply chain management is essentially a service function whose role is to fulfill the business that other management colleagues shape and create. All too often, they feel stuck with trying to optimize their systems to respond to a fundamentally problematic set of business requirements. At a deep level, they are concerned with "being effective," having a quantum impact on the company beyond meeting their cost and service targets.

Five steps to supply chain productivity
In my experience working with effective supply chain managers, I have found that five steps are essential for supply chain managers to shift their role from cost control to ROIC maximization.

Decide to be responsible for supply chain productivity, not just supply chain management. Make the earning power of your assets a prime focus of your job. Look around the company, and see who's involved in this process. The odds are that your company does not have an explicit profitability management process, and asset productivity is simply (and incorrectly) assumed to be maximized if everyone makes budget. For a more detailed explanation of profitability management, see my first column, "Who's Managing Profitability?"

Analyze your supply chain productivity. Create a model that (1) identifies the inventory supporting each product, each order, and each customer (if you are a retailer, the inventory supporting each SKU [stock-keeping unit] in each store); (2) identify the revenues and net profit generated by each of these assets; and (3) combine these measures to create a database of ROIC for each product, order, and customer. You can complete this process on a PC at "70 percent accuracy" in a few months.

The database will show you the asset productivity of the different elements of your supply chain. Expect to see some very profitable business, a lot of marginal business, and a surprisingly large amount of business that is unprofitable by any measure. With this database, you can quickly identify which parts of the business you should nurture and grow, which measures can make the marginal parts of the business more profitable, and which parts of the business you should cede to your competitors. Your colleagues in Sales and Marketing will surely be very interested in this information as well. For a more detailed explanation, see "The Hunt for Profits."

Take the lead in coordinating with your counterparts in Sales and Marketing to systematically improve ROIC. Here are a few key leverage points: (1) account selection; (2) relationship selection (e.g., arm's length vs. customer operating partnership); (3) sales process selection (e.g., direct vs. telesales); (4) service differentiation (different order cycles for different customers and products); and (5) product life cycle management (knowing where and when to stop holding inventory on a short life-cycle product).

These key elements come together in the account planning process. Therefore, it is critical that you get involved in this process, and not simply cede it to the Sales and Marketing groups. Account planning, more than any other process, will determine your supply chain productivity. For more on this, see "Reconnect Sales Management to Profitability."

Two things are new here. First, the supply chain productivity (ROIC) model can form the basis for a companywide understanding of profitability, and for a very granular, coordinated program for rapid improvement. Second, the company's account plans can be connected to the ROIC model to project, manage, and monitor concrete progress.

Differentiate your company from your competitors using supply chain capabilities. This will have a big impact on supply chain productivity and company profitability.

Today, most companies are reducing their supplier bases by 50 percent or more. The suppliers that remain see huge, immediate increases in market share. The key element that determines which supplier gets this increase, and which supplier loses it all, is the supplier's ability to operate and create change within the customer. Winning suppliers know how to increase their customers' internal profitability. This is the fastest and surest way to increase market share today, and it is first and foremost a supply chain productivity issue.

The supply chain managers of leading suppliers have detailed knowledge of their customers' internal processes and economics. They have the capability to work with their customers to increase the customers' inventory turns, to deliver products directly to needed locations, and to develop information that makes the customers much more profitable. These are all supply chain capabilities.

Manage change both internally and externally. Maximizing supply chain productivity requires not only good information, but most importantly, great change management. Within your company, this means developing a detailed, holistic picture of ROIC, and engaging your counterparts to join you in a coordinated program of ROIC improvement. Within your customers, it means much the same thing: developing an understanding of customer profitability and ROIC, and engaging key customer managers (along with key counterpart managers in your own company) in an effective program of change and improvement.

Managing supply chain productivity
Ultimately, shifting from supply chain management to supply chain productivity involves changing your perspective:

- broaden your view from supply chain cost management to ROIC management,
- broaden your playing field from supply chain assets to overall company activities, and
- broaden your management focus from your own company's operations to encompass your customers' operations as well.

More than anything else, supply chain productivity requires that supply chain managers become experts at knowledge generation and change management. Armed with these capabilities, supply chain managers can step up to the vital task of creating their companies' future.

See you next month.

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