Value Focused Supply – Linking Supply to Competitive Business Strategies

A Major Research Initiative of CAPS Research and A. T. Kearney, Inc.

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Abstract. This paper provides an overview of selected results from research conducted with fifteen leading world-wide supply organizations about how value is being achieved through value focused supply category strategies. Drivers of value focused supply and selected strategy examples are provided. A process overview and key enablers are also presented. The complete CAPS Research report will be available late second quarter, 2010.

Research Background

In the past two decades, companies, institutions and governments have saved $ hundreds of billions by aggressively applying competitive sourcing techniques to their spend base. By following disciplined step-by-step approaches, companies gained control over how they spent the 50, 60 or even 70 percent of their revenue that flowed to suppliers. Advances in information technology allowed companies – many for the first time—to gain visibility into what they were spending, where, and with which suppliers.

Looking back over the past 20 years, it is clear that competitive sourcing created significant value for companies, driving major cost savings directly to the bottom line. However, the widespread use of competitive sourcing techniques and tools has eroded the major advantage that it gave pioneers in the 1990s. A.T. Kearney’s 2008 Assessment of Excellence in Procurement (AEP) research found that the savings gap between “leader” and “follower” companies had shrunk by half just since 2004. For many categories of spend, continued attention on competitive sourcing will remain necessary just to keep up.
However, value derived from sourcing cost savings will not be enough in the coming years. Even before the economic crisis of 2007 – 2009, CEOs’ future expectations of the supply organization rose significantly. As shown in the AEP research, the most extensive increase in expectations is for more value creation through innovation and growth and value chain optimization.

Since the crisis, macroeconomic forces and competitive conditions are creating a turbulent and uncertain business environment (the “new normal”) that are driving companies into uncharted waters. Just saving money on external expenditures will not be enough to survive, let alone thrive in the years to come.

For the most strategic categories of spend, the task instead will be to use the supply base as a resource to both supplement and complement the company’s resources and to use this combined capability to improve overall company competitiveness by creating additional value for both customers and shareholders.

These new, more advanced value focused supply and category strategies are the target of this research. The aim is to understand how a holistic value approach differs from traditional competitive sourcing approaches, examining the changes it requires to areas such as company and supply philosophy, value goals and metrics, sourcing and supplier management approaches and internal and external teaming for the strategic purchases of the firm. It will also examine the type and level of C-level executive involvement, understanding and support needed to ensure tighter linkage between business strategy and supply and deeper cross-functional collaboration.

**Research Objectives and Approach**

**Objectives**
The research team identified four objectives for this research effort:

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

**Approach**
Because value focused supply (VFS) is still in its early stages, the research team adopted a case-based approach to the research effort. By comparing and contrasting how leading
companies were approaching VFS, we sought to understand both what was working successfully today, and what opportunities existed to improve how value was created for specific category situations and how companies could generalize techniques and lessons across key categories.

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

- an in-depth understanding of how a company approached VFS for one of its strategic categories (the “case example”)
- profiling how the company had extended VFS across its portfolio of key categories (the “company narrative”) and the degree to which the approach was formalized

Fifteen companies participated in the research, representing a wide variety of industries including aerospace and defense, automotive (OEM and supplier), consumer durables, consumer packaged goods, engineering, construction and procurement (EPC), health care delivery, high tech, industrial control systems media and entertainment, pharmaceuticals and raw materials processing.

**What is Value Focused Supply Management?**
At its core, value focused supply management is an approach for creating and implementing longer-term strategies for key purchase categories and their suppliers that go far beyond just competitive sourcing. The focus is on increasing value for customers and the company by improving both the attractiveness and the competitiveness of the company’s end products and services. Ideally it 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. 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 itself. Details are provided in the final report.

Ultimately, value to the consumer translates into value to the company in the form of revenue. But value focused supply management includes more than just a focus on boosting the company’s top line. In fact, it seeks to create (or in some cases protect) value along four dimensions: revenue, cost, assets and intangibles, ultimately producing profitable long-term growth.

**Systematic Process is Required**
Major differences between competitive sourcing and VFS are the increased emphasis on and data/information collection and analysis, holistic value goals (i.e.; beyond cost) and creativity required in strategy development when:
• Evaluating the purchase category’s strategic role in the company. Two detailed screening processes are required. The first establishes those purchase categories that are truly strategic to the business and to key product competitive position. The second selects those top priority purchase categories to maximize impact of resource investments.

• Setting holistic value focused goals for the category. Goal areas are detailed with metrics for revenue, costs, assets and intangibles. Value is created by setting detailed goals and metrics that either protect value or create value in each performance area.

• Understanding details of the purchase category. These include the requirements of the ultimate customers that will impact what is purchased, the dynamics of the supply market and specific supplier capabilities. Overall the breadth and depth of the data collection and analysis increases significantly. For example, the linkage between customer and company business, product and technology strategies must be clearly understood. Understanding where value is created in the supply network is critical as is the detailed application of value mapping tools, supplier and network optimization, supplier needs analysis, product design complexity and so forth.

• Evaluating and selecting strategic supply options. These strategy alternatives were found to focus on changing supply market dynamics, how the company works with suppliers, or changing what is purchased and/or what the customer needs. Significant creativity and innovative thinking is required when developing VFS to go beyond the traditional approaches of price-focused volume leveraging, competitive bidding, aggressive negotiations and low cost country sourcing.

Significant resources must be committed to develop and execute VFS. It cannot be business as usual for those purchases considered most strategic to the company.

Selected Value Focused Supply Opportunities
The companies in the research used a wide range of creative strategies to generate value as illustrated in these high level examples:

• Create a new supply chain and block competitors

• Gain control of the supply/value chain

• Achieve technology leadership and establish an industry standard

• Create better transparency about what are/should be competitive prices based on price indices and rate of change

• Capture value created elsewhere in the value chain

• Improve supply chain flexibility to outperform competitors for market share and revenue
Seven Types of Enablers
To develop and implement value focused supply strategies, participating companies employed seven types of enablers. They all furthered a sharp focus on value alignment and a holistic view of value creation. In addition, individual companies used these enablers in different ways and to different degrees. The enablers were:

1. Executive engagement
2. Value chain/network goal alignment and measurement
3. Deep supply market understanding
4. Collaborative approaches
5. Supplier relationship characteristics
6. Information/analytical capabilities
7. Organization and resources

Is Your Company Ready for VFS?
Critical questions for your company to address when considering value focused supply for strategic categories.

- Where does value focused supply fit into your business strategy?
- What barriers do you need to overcome?
- Do you have the right people to do it? Why are they the right ones?
- How thoroughly do you know what your company’s business and technology strategies are?
- Is creating a more formal structure and approaches to “competing through value focused supply” a good thing for you to do? Why/why not?

How will you know when you have achieved Value Focused Supply?
Companies that have achieved Value Focused Supply will be able to live up to a mission statement that creates or enables supply 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 buy to support our company’s strategic objectives, instead of 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 **trusted provider** of knowledge and 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 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 customers, other company functions and suppliers to **map value focused supply strategy creation and implementation**, instead of just a contributor to the efforts of others.

By fulfilling this mission, Supply will take its place as a key role in meeting our company’s strategic objectives, along with market impact, financial resources, human talent and technological assets.