Value Focused Supply: Linking Supply to Competitive Business Strategies

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

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CAPS Research

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Forward

The mission of supply management organizations continues to evolve in response to economic conditions, technology advances, company strategies and supply market opportunities. Prior to the 1950s, purchasing organizations were primarily charged with simply ensuring availability of supply. The decades that followed brought everincreasing attention to obtaining reasonable prices in addition to ensuring availability. The 1990s saw an explosion of "competitive sourcing" — first as a means to apply company leverage to supply markets to obtain improved prices, and later as a way to help drive down total cost of ownership.

Competitive sourcing remains a powerful tool for many categories of spend. However, market conditions require — and senior executives demand — that supply management organizations deliver more than just cost reduction going forward. Finding ways to generate more value from supply markets and supply relationships is becoming supply management's new mission.

In this report, CAPS Research and A.T. Kearney, Inc., explain how 15 leading companies are already responding to this new mission. The research examines the strategies, approaches and enablers that are in place at these companies and illustrates through case examples the successes they have had.

This research effort is the fourth in a series of joint efforts by CAPS Research and A.T. Kearney that explores executive issues in supply management. The previous studies are:

- Succeeding in a Dynamic World: Supply Management in the Decade Ahead (2007)
- Outsourcing Strategically for Sustainable Competitive Advantage (2005)
- The Future of Purchasing and Supply: A Five- and Ten-Year Forecast (1998)

Copies of the studies are available from the CAPS Research Web site at www.capsresearch.org. Select "Research" and then "Focus Studies."

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Executive Summary

Value Focused Supply (VFS) strategies will provide the next breakthrough opportunity for companies to create and capture value from their most strategic purchases. These VFS strategies go far beyond the price/cost reduction of traditional competitive sourcing. Already, leading companies are clearly demonstrating the power of this more comprehensive approach. Senior executives who lead their companies to be among the first to systematically apply VFS across the supply network will have opportunities to protect and create significant competitive advantages.

Looking back over the past 20 years, it is clear that competitive sourcing created significant value for companies by driving hundreds of billions of dollars in collective 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) global research study found that the savings gap between "leader" and "follower" companies had shrunk in half since 2004. For many categories of spend, continued attention to competitive sourcing will remain necessary just to keep up.

However, with tougher global competition in virtually every market, merely saving money on external expenditures will not be enough to survive, let alone thrive, in the years to come. Companies must find and mine additional value from their supply relationships. The supply network needs to contribute holistically to the company through innovation and growth, asset utilization, sustainability, risk management and overall competitiveness as well as cost.

In response to these new challenges for supply management, CAPS Research and A.T. Kearney teamed up to conduct research with 15 leading companies to discover how they are achieving overall value improvement for strategic purchases. In-depth interviews were conducted with key individuals at these companies to gain insights into selected value-focused purchase categories and overall company and supply strategies.

Specifically, the research addressed the following VFS questions:

- How are companies implementing VFS? What results are being achieved?
- What strategic and operational approaches can be developed to accelerate implementation of VFS with suppliers and supply networks?
- What are the critical issues and inhibitors to implementing VFS? How can they be overcome?
- What is the role of supply management in developing and implementing VFS?

At its core, Value Focused Supply is an approach for creating and implementing longer term strategies for key purchase categories and their suppliers that go far beyond traditional 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.

Value creation was found to result in revenue enhancements, cost reduction, asset optimization and achievement of intangibles. This value was achieved by eliminating value leakage, increasing current value, creating tomorrow's value and stretching for added value.

The companies studied employed a wide range of strategies to drive more value from supply. Examples include:

- A company that established a brand new value chain to break an upstream monopoly. Its alternative sources of supply let it slash lead time for customer orders, resulting in major market share gains and dramatically increased revenues while blocking competitors from adopting a similar strategy.
- A company that teamed with a strategic supplier to develop a new technology. Collaborative development brought its product to market well ahead of competing offerings, driving market share growth and revenue/profit increase for both the company and its supplier.
- A company that leveraged its focused volumes with selected suppliers to achieve equity rebates as the selected suppliers grew and their market value increased.

Across the 15 organizations, we found a number of critical enablers that were required to achieve VFS. These included executive engagement, value chain goal alignment and measurement, supply market understanding, collaboration approaches, supplier relationships, information/analytic capabilities, and organization and human resources.

Based on our analysis across the participating companies, a few observations stand out.

First, VFS strategies are based on mapping customer needs and what they most value, then aligning and applying company and supplier resources to create value for customers. These strategies are frequently evaluated in terms of meeting overall business unit and/or product line goals and financial return on investment.

Second, highly capable supply and other functional personnel, including executives, were typically engaged in VFS strategy creation and deployment. The complexity of these strategies required creative and talented people who could influence other key decisionmakers to commit resources and support the strategy.

Third, these VFS strategies require a holistic set of measures and incentives to evaluate success that are significantly related to the success of the business versus traditional price improvement measures and typical performance expectations of supply.

Finally, the role of supply varied from strong leader to participant in VFS strategy development and execution. It was obvious that supply could not create and lead all efforts but should play an "appropriate" and influential role based on the situation. The research also found a need to further develop organization and process approaches to accelerate Value Focused Supply and further connect with stakeholders and senior management. This can be done by establishing stakeholder and supply executive committees to drive and guide VFS. We also believe that Value Focused Supply will become an equal component of company strategy along with marketing, finance, manufacturing and technology over the next five to 10 years.

This research report provides the detail behind our findings and includes:

- Why Value Focused Supply is important
- Key overall findings
- Examples of Value Focused Supply strategies
- A framework for implementing Value Focused Supply
- Enabling Value Focused Supply
- Conclusion

Chapter 1: Why Value Focused Supply Is Important

Research Background

In the past two decades, companies, institutions and governments have saved hundreds of billions of dollars 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 percent, 60 percent 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.

Greater scrutiny of specifications and usage patterns helped reduce wasted spend. Rigorous use of detailed requests for information and requests for proposals gave companies unprecedented understanding of supplier capabilities and supply market options, and allowed for fact-based examination of bids.

By combining spend across divisions and geographies and concentrating spend with fewer suppliers, companies came to muster and apply leverage they never realized they had. Standardized approaches to sourcing brought rigor and discipline to both factfinding and analysis. Tools such as e-RFI/RFPs, electronic auctions and optimization models intensified competition, sped up the sourcing process and improved decision-making.

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, 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) global research study found that the savings gap between "leader" and "follower" companies had shrunk in half since 2004 (see Figure 1-1). For many categories of spend, continued attention to 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, CEO expectations for supply had expanded well beyond cost reduction to include innovation and growth, risk management, value chain optimization and even sustainability (see Figure 1-2).

Since the crisis, macroeconomic forces and competitive conditions have created an even more turbulent and uncertain business environment (which some have dubbed the "new normal") that is driving companies into uncharted waters (see Figure 1-3). Slower overall growth intensifies competition and leaves less room for error. Restrained, less trusting customers are redefining what they value, with rippling effects through companies' product and service portfolios. Increased government power is placing new regulations on how businesses will operate. Increased government borrowing for social programs and fiscal stimulus portends higher taxes, greater currency fluctuations, higher interest rates in the commercial sector and a possible return to inflationary times. Growing demographic pressures are accelerating the shift in consumer buying patterns as well as shrinking the size of the workforce in many developed countries while expanding the workforce in developing countries. Intensifying resource competition, particularly for food and fuel, will constrain growth opportunities and drive costs up. 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

Followers are catching up to leaders in terms of savings achieved across all spend categories





Source: A.T. Kearney 2008 AEP Study

thrive, in the years to come. Companies must find and mine 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 as well as cost.

This is especially true for those relatively few categories of spend in each organization's portfolio that are too sensitive or strategic for traditional competitive sourcing approaches. In these areas, 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 customers and shareholders.

These new, more advanced Value Focused Supply strategies are the target of this research project. The aim is to understand how a holistic value approach differs from traditional competitive sourcing approaches. The research examines 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 strategic purchases of the company. 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 crossfunctional collaboration.

When we began this research, we did not have a clear idea of the progress to date that leading companies had made with VFS approaches. Through the interviewing process, we were pleasantly surprised to learn that several companies had creative and innovative advanced approaches in place for certain key categories.

However, we also observed that the successes to date generally came in response to specific triggers or crises rather than through a proactive, systematic approach to deliver more value across all key purchase categories.

Because VFS is still in its early stages, this research affords the opportunity for joint learning to improve the process and accelerate results.

Overall, executive expectations of supply are increasing to deliver greater value beyond cost



Source: 2008 A.T. Kearney AEP Study

Research Objectives and Approach

The research team identified four objectives for this research effort:

- 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 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

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

As shown in Figure 1-4, there are two initial hypotheses for the research. We hypothesized that companies that are successful at VFS:

- Follow a value-focused process for key categories

 linking to current and future business and technology needs, establishing fact-based value goals for the category, and formulating, implementing and measuring strategies to achieve those goals
- 2. Invest in process enablement to conceive, identify, deliver and sustain value

The research began with a series of 30-minute telephone interviews with leading companies that had some experience in VFS. This helped the team to confirm interest in the proposed research and frame the dimensions of VFS that would be covered in the research.

Cost savings will not be enough in the turbulent, uncertain business environment of the "new normal"



Source: A.T. Kearney, Inc.

Next came the development of the research strategy. We wanted answers to these key research questions:

- How are companies implementing VFS? What results are being achieved?
- What strategic and operational approaches can be developed to accelerate implementation of VFS with suppliers and supply networks?
- What are the critical issues and inhibitors to implementing VFS? How can they be overcome?
- What is the role of supply management in developing and implementing VFS?

Our approach involved looking at VFS from both a bottom-up and top-down perspective within a company. This was achieved by:

- Gaining an in-depth understanding of how a company approached VFS for one of its strategic categories (the "case study 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

Research Participants

The team identified about 25 companies as potential participants in the research, based on a combination of our first-hand knowledge of the company's capabilities and secondary research. Each company was asked to participate in a pair of two-hour telephone interviews, one covering the specific case and the other looking at the companywide approach.

Ultimately, 15 companies agreed to participate in the research, representing a wide variety of industries including aerospace and defense, automotive (OEM and supplier), consumer durables, consumer packaged goods, engineering, procurement and construction (EPC), healthcare 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.

Because of the sensitive nature of their strategies, the companies asked to remain anonymous in this report.

Going-in hypothesis: Successful companies systematically pursue value focused supply strategies

Companies that are successful at VFS	Have a value- focused process	Invest in process enablement
Linkage to current and future business and technology needs	Understand how business strategy affects/will affect supply requirements and ensure alignment	Develop and deploy the: • Organizational capabilities • Cultural changes
Fact finding and goal setting	Define value sources and strategic goals for key categories	 Internal/supplier relational behaviors Management
Strategy formulation, implementation and measurement	Create and implement sustaining and breakthrough strategies to capture value	processes necessary to create, identify, deliver and sustain value

However, they have allowed us to publish their case studies using disguised company names and somewhat disguised details. Throughout the report and its appendix, we will be referring to the companies by their disguised names, as listed in Figure 1-5. Appendix A contains case study information for each company.

The primary source of data for our analysis was the interviews and document review with key persons across procurement/supply management who were knowledgeable about VFS overall and were able to describe a case example of VFS. Additional insights came from review and discussion of the preliminary findings in a full-day conference with the study participants in January 2010.

Defining Value

Before discussing Value Focused Supply in-depth, it is important to first define what value is and how it is created. In the paragraphs below we will examine value as perceived by the consumer or end user and by companies selling to them.

The Consumer/End-User Side

Volumes have been written on the topic of consumers and end-user value creation, and in this research we do not intend to plow new ground around this concept. However, it is useful to reiterate some of the basic principles.

In short, consumers and end users gauge the value they receive from a product or service in terms of the set of benefits they get from owning and using it compared to the cost of owning or consuming it.

Benefits can be as concrete and measurable as functionality and performance (e.g., speed of an automobile, throughput of a piece of equipment or nutritional value of a food item) or as ephemeral and subjective as improved social status or self gratification (e.g., fashion items). They can be based on fulfilling an already known need, or on creating and then satisfying an unknown need, similar to what Apple's iTunes and iPod did by making digital music more available, affordable and portable.

Different segments of consumers or end users can place very different weights on the various benefits. For

Participating companies represented numerous industries

Company (disguised)	Industry group	Value "headline"			
Apollo	Media and entertainment	New packaging sets industry standard – boosts sales			
Bentham	Engineering, procurement and construction	Company creates new supply chain — bypasses chokepoint, boosts sales			
Bigtru Co.	Automotive supplier	Company and supplier co-develop new alloy – gain huge headstart for future products			
Carco, Inc.	Automotive OEM	Novel approach to tooling cuts costs throughout the value chain			
ComCo, Inc.	Power systems	Company 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	Both company and its suppliers benefit from aligning resources with what consumers value			
Globalgoods	Consumer packaged goods	Company finds novel ways to share in increased supplier value			
Healthifoods, Inc.	Consumer packaged goods	Supply strategies help drive developing market growth			
HiTech, Inc.	High tech	Collaboration on component design propels company to one-year lead over competition			
Meditrend	Healthcare 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	Collaboration with suppliers boosts quality, cuts cycle times and slashes costs			

example, a high school or college student purchasing a notebook computer might emphasize styling and the latest in multimedia capabilities at a low cost while a small office/home office (SOHO) customer might place more weight on reliability and service support at a competitive cost.

These differences influence product design, functionality and cost, and in turn impact strategies for acquiring components such as cases, displays, disk drives, motherboards and keyboards. Even within a category, the notebook manufacturer may have a different strategy for supplying flashy designer-logoed cases in a rainbow of colors to the student market, versus supplying a simple yet rugged black case to its SOHO market.

The Company Side

Ultimately, value to the consumer or end user translates into value to the company in the form of revenue. But

revenue growth is only one dimension of direct financial value creation for a company. Also included are cost improvement and asset productivity, as shown in Figure 1-6. The company's supply management organization and its supply base can contribute value in each area. (In Chapter 3, we also introduce the concept of how a company can create value through "intangibles" such as customer loyalty, intellectual property, corporate reputation and sustainability.)

Value does not just accrue to the buying company; it also accrues to the supplier companies as well. As illustrated by several examples in this report, suppliers have seen their share of business grow, have added volume due to higher "pull-through" of their products and services, and improved their own cost base and capabilities by collaborating with customers on Value Focused Supply strategies.

Strategies for key purchases and suppliers require alignment with evolving company strategies



Given the pace of change and uncertainty, these strategies must also be agile and dynamic

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. This helps to isolate those categories that are critical to driving value in the end markets. It also allows the company to focus on shaping and using the capabilities of the supply base to complement and supplement its own capabilities, and in turn create more value for the customer and itself.

Our research found that VFS is as much a mindset as an approach. To be sure, it is often built on rigorous data collection and analysis to understand the value that different customers and segments place on various attributes of the company's end products. In turn, these value drivers are translated into supply-side requirements. However, it also depends on creativity and imagination to identify and consider any and all levers to create or unlock value from the supply base, and an organization committed to and capable of making it happen.

Chapter 2: Key Overall Findings

A number of key findings across all 15 participating companies provide insights to other companies competing through Value Focused Supply (VFS) and overall supply excellence. These findings are presented below and discussion follows.

- 1. Value was either "protected" or "created" by VFS strategies for strategic purchases.
- 2. All participating companies knew which supply categories were most strategic to their business based on annual spend value, technology access, criticality of supply, etc. but fewer companies had a clear line of sight between their supply strategies and the direct impact of these strategies on the end customer, sales, market share and profitability.
- 3. The more advanced value-focused strategies exhibited two themes — a sharp focus on value alignment and a holistic view of value creation.
- 4. Major triggering events outside of supply were frequently the drivers of VFS strategy development.
- 5. Value-focused goals and resulting strategies were as varied as the participating companies, the categories and individual situations.
- 6. While the value-focused strategies used traditional approaches to protect and create value, some also went beyond to create significant innovative and future value.

1. Value Was Either Protected or Created

VFS strategies that protected value were typically crafted in response to situations requiring fixes to major problems impacting performance to customers and/or to unfavorable supplier relationships that limited joint value creation. For example, Powercon, a manufacturer of industrial control systems, had to correct a key supplier's on-time delivery problem that was leading to an increase in Powercon's inventories, production inefficiencies and late shipments to customers. At ComCo, a manufacturer of power systems, supplier relationships had to be dramatically improved so that suppliers' value contribution to product design could be protected.

Other participants were found to be creating current or future value. Pharmacare, a pharmaceutical manufacturer, created current value by changing the way prices were established for external legal services, thereby significantly reducing costs. Duraman, which manufactures consumer durables, created future value by jointly implementing multiple supply strategies with engineering to reduce product complexity and enhance supplier collaboration by applying nontraditional approaches, thereby improving customer value through better products at lower cost.

2. Strategic Purchases Were Identified at All Companies, but Fewer Companies Had Clear Line of Sight between End-Customer Requirements and Their Supply Strategies During the interviews, we were not surprised to learn

that all participating companies could easily identify their strategic purchase categories. Size of spend, key technologies, impact on end-product quality and potential for an adverse customer impact all factored into the equation. While the more advanced strategies among the 15 cases demonstrated a strong and direct line of sight from what customers valued most in the company's end products back to the types of value these key categories needed to deliver, most of the others did not. Going beyond the categories in the company case examples, the links were not as strong.

Looking ahead, we believe that companies can benefit from tighter links between the customer's or end-user's view of value and how resources are deployed and aligned, both internally and as reflected in the strategies for key purchase categories.

3. More Advanced Strategies Exhibited Two Themes

Figure 2-1 illustrates two themes that were associated with more advanced Value Focused Supply strategies.

There was a very sharp focus on value alignment from the ultimate end user of the product/service back through the participating company and to multiple tiers of suppliers. Some companies had a clear understanding of what the end customer valued and would pay for (e.g., type of packaging, variety of product offerings and technology such as speed, size, weight) and would develop VFS strategies around these needs. This included providing information to suppliers about specific requirements to meet needs, such as aesthetics of packaging required from suppliers to establish an industry standard or new technology required to offset increasing costs and reduce weight of the product.

Understanding/shaping customer needs, typically initiated by demand-side functions such as marketing and sales, and clearly communicating these needs to suppliers was critical to successful value alignment. With an understanding of what customers valued, the appropriate supply, technical, operations, financial and other resources could be marshaled to focus on the correct value-creating work. For example, the product mix at Carco, an automotive manufacturer, had significantly increased due to marketing's strategy to pursue specific market niches. The company's supply and technical groups were able to work with multiple tooling suppliers and their tier-one parts providers to modify specific mold materials, their life cycles and costs. This changed tooling suppliers from commodity providers to value-creating suppliers, positively affecting product manufacturability, design, quality and flexibility. Collaborative practices within the supply network were also enhanced.

Study participants took a holistic view of value creation across their value chains/networks. The holistic elements shown in Figure 2-1 were evident from both the overall interviews and the case studies. A broadbased set of philosophies, business approaches and cross-functional collaboration was used to support information gathering, analysis and decisions. Executive engagement, broad value-based goals and innovative supply strategy development were also in play. These holistic company perspectives and enabling conditions went far beyond the traditional goal of meeting yearover-year price improvement objectives.

4. Major Triggering Events from Outside of Supply Were Frequently the Drivers of Development of Value Focused Supply Strategies Across the 15 companies, a variety of triggering events were found to be key drivers for development of the VFS strategies. These events, which were widely dispersed across industries, included:

- Significant material price increases and/or lack of or constrained availability
- Customer service failures (e.g., delivery or quality)
- Shifting of external customer requirements and/or company marketing strategy
- Critical support for new product development and introduction
- A leadership mandate requiring and supporting enhanced business unit and product competitiveness

Although these triggering events drove VFS strategies, these strategies appear to be more reactive to problematic situations rather than proactive to opportunities. A proactive supply approach can be established by asking the question:

"How can current and future financial returns be increased for the business unit through development of value-focused strategies that enable companies to provide greater value to customers than competitors can?"

5-6. Value-Focused Goals and Resulting Strategies Were Varied, but Some Value-Focused Strategies Far Exceeded Traditional Approaches

The case examples provide a wide variety of situations with varying value-focused goals, weightings and supply strategies. Goals included revenue, cost, asset and intangible performance objectives. Examples of goals to be achieved through VFS strategies included:

- Increasing revenues
- Creating an industry standard
- Improving customer service
- Reducing price/cost
- Enhancing value chain integration
- Reducing total cost of ownership
- Improving asset utilization
- Tailoring assets to markets
- Creating competitive barriers
- Creating and leveraging intellectual capital

Although these example goal areas may not be unique to supply executives, they are broader in scope and depth than typical annual price reduction focused goals. The most advanced VFS strategies, however, provided the greatest insights into VFS strategy creation and innovation. These strategies can be grouped into five broad categories: Figure 2-1



The more advanced strategies exhibited two themes

- 1. Creating alternative supply options, supply chains and networks
- 2. Rationalizing internal use to reduce demand, eliminate non-value-adding product/service characteristics and improve customer value
- 3. Creating value-adding technology through tightly coupled research and development collaboration with suppliers
- 4. Improving cross-functional, cross-enterprise and supplier capabilities and processes, including integrating operations with suppliers
- 5. Generating revenue directly through supply strategies

Examples of strategies that went beyond traditional ones are briefly discussed below. The 15 case examples in Appendix A provide more detailed information.

A number of study participants created alternative supply options as part of their VFS strategies. Metropolitan, a raw materials processor, performed backward integration into its own operations and also used market intelligence to reshape index-pricing practices within the supplier marketplace. Engineering, procurement and construction company Bentham developed brand new sources of supply for critical raw materials and fabrication and was able to block competitors from the new supply chain by committing to the capacity. Healthifoods, a consumer packaged goods manufacturer, created a completely new network of equipment supply sources in low-cost countries that brought with it insights and market intelligence about what local consumers valued in their food and beverage products. Healthifoods used this growth market information to capture market share and increase competitive cost pressures on current suppliers in higher cost geographies.

Rationalizing demand and non-value-adding product characteristic strategies also provided customer value and improved performance. A number of companies were reducing or rationalizing their product specifications and determining whether their products were over-specified compared to industry standards. For example, consumer packaged goods company F&B rationalized its specifications based on extensive customer surveys to pinpoint those aspects that the ultimate customer found truly valuable and worth a price premium. Duraman undertook an extensive worldwide effort in which purchasing, engineering and business unit leaders collaborated to reduce product complexity and better align material specifications to customer needs.

Tightly coupled R&D collaboration with suppliers to create new technologies that would increase market share and profitability were also considered to be valuecreating strategies. These types of strategies are organizationally and technically complex and require significant investments. Automotive supplier Bigtru codeveloped a proprietary super alloy with a key supplier. The resulting technology development enhanced product performance in a severe physical environment and provided greater value to customers, improving the company's market position. At HiTech, a manufacturer of high-tech equipment, a new product that was codeveloped with a supplier enabled the company to bring a new technology to market earlier than the competition for a specific market segment, resulting in increased market share and profitability.

Supply strategies that focused on enhancing processes, capabilities and integration across functions, enterprises and at suppliers also went beyond the norm to create value. For example, F&B worked with suppliers to improve intercompany processes to bring new production lines into operation faster than they typically had in the past. At Techco, a high-tech company, the supply strategy was to rationalize the supply base for a product line critical to business success and then collaborate with the reduced number of suppliers on both process improvements and supplier capability development. The efforts resulted in technology, speed, cost and quality improvements.

Powercon had a major problem with an important supplier's on-time delivery performance that was impacting customers and asset utilization. It deployed Six Sigma expertise to analyze all aspects of the supplier's capabilities, processes and cross-enterprise communications/processes. Subsequently, changes were made to inventory decision rules, communication of requirements and customer performance metrics at the supplier, resulting in an increase in on-time delivery performance from less than 50 percent to more than 95 percent.

Two examples provide insight into how supply strategies led to increased company revenues. At consumer products company Globalgoods, supply management observed that suppliers were gaining significant value (e.g., sales revenue, profits and value of the company) from conducting business with the company. Globalgoods understandably wanted to participate in this value creation, so it determined which spend categories gave suppliers the potential to benefit from its volume and "reputational lift." Supply management then determined which suppliers in those spend categories had an ownership structure typically private equity or simple proprietorships — that would make them suitable for value sharing. After working with the legal and finance departments, the company developed value-capturing mechanisms that have allowed it to achieve "equity-value rebates" through work with two of its suppliers, with additional efforts being explored.

In the second case, Bentham found that soaring industry global demand for end products created the need for a significant increase in conversion capacity in its end-user markets. However, there was an upstream capacity bottleneck and a monopoly for a specialized piece of equipment that stretched lead times to increase conversion capacity out to three years. In response, supply designed a new supply chain that it successfully "sold" to executive management. This new supply chain included specialty steel suppliers and fabricators that were necessary to produce the very large and expensive piece of specialized equipment at the heart of the endeavor.

Using its new supply chain, Bentham was able to reduce lead times for the equipment by 50 percent, allowing its ultimate customers to increase their production and capture returns on their investment months earlier. The company also became the clear market leader, won multiple contracts with increased revenues and was able to sell steel plate to fabricators.

Figure 2-2 summarizes the specific triggering events and resulting VFS strategies across all 15 companies in the research study. The companies are listed by their pseudonyms and shown with their industry, the strategic purchase, triggering event(s) and resulting VFS strategies. The figure can be used:

- As a snapshot depicting triggering events and VFS supply strategies among the research participants
- As a guide to refer to the case studies in Appendix A, which portray the full situation and results
- To help other companies identify situations similar to their own, and potential VFS strategies that might apply

Overall Value Focused Supply Observations and Enablers

Based on our analysis across the participating companies, a few observations stand out.

VFS strategies are based on an understanding of customer needs and what they most value so that all appropriate functions can work with supply management to apply resources to customer value

Triggering events drove creation of VFS Strategies

Company		Apollo	Bentham	Bigtru Co.	Carco, Inc.	ComCo, Inc.	Duraman, Co.	F&B, Inc.
Industry		Media and entertainment	Engineering, pro- curement and construction	Automotive supplier	Automotive OEM	Power systems	Consumer durables	Consumer packaged goods
Strategic Purchase		Packaging for new innovative product	Highly special- ized processing equipment	Steel alloy	Tooling for injec- tion molded parts	Fabrications for power systems	Raw materials and components	Ingredients
Primary Trigger	Material Price Increases and/or Con- strained Availability		Shortages of spe- cial equipment capacity causing long lead-times for processing plant construction	Rising material prices and few suppliers			Raw material price increases	Ongoing com- modity price rises
	Customer Service Failures							
	Shift in Customer Require- ments and/ or Marketing Strategy		Substantially higher demand for capacity capable of processing spe- cific grade of raw materials	Higher alloy per- formance required due to product design and alter- nate energy requirements	Demand shift from a few high volume models to many lower volume models	Requirements for higher energy efficiency in the power systems		Recognition of dif- ferent consumer value equations for different brands and end products
	Support For New Product Development/ Introduction	Innovative pack- aging needed to support intro- duction of new product brand				Development of next generation power system		
	Leadership Mandate to Increase Competitive- ness					Organization/ Supply must change to compete	Achieve cost leadership	Focus on overall margin increases to ensure the com- pany delivered on promises to Wall Street
Strategy Approach	Create Alter- native Supply Options	Licensing of IP to alternate suppliers	Find alternative sources for mate- rials and fabrica- tion, and control capacity					Add internal capacity to manu- facture some products in-house
	Rationalize Internal Usage To Remove Waste & ImproveValue Received						Remove com- plexity from product designs and better align material specifica- tions with needs	Reexamine product formu- lations relative to consumer value equation; specification rationalization
	Collaborate Tightly with Supplier on R&D	Joint design, IP agreement		Co-develop pro- prietary "super- alloy" with supplier	Collaborate with tier 1 parts sup- pliers and tool- makers on tools for new models	Close involve- ment of sup- pliers in design of the new power system		Involve sup- pliers in product reformulation
	Improve Capabilities & Processes and Inte- grate Opera- tions with Suppliers				Use new design concept ("same but different") to speed up design and development of tools. Help tool- makers innovate in the use of tech- nology and busi- ness processes	Continue to ratio- nalize supply base and work with suppliers to improve cost, quality and delivery for existing power systems	Solicit supplier input to mate- rials alternatives. Keep competi- tive pressure on prices with global sourcing	
	Use Supply To Directly Generate Revenue		Use special- ized equipment capacity-avail- ability to position the company as a preferred supplier able to reduce lead times by half and help cus- tomers generate revenue faster	Achieve market leadership				

Globalgoods	Healthifoods, Inc.	HiTech, Inc.	Meditrend	Metropolitan, Inc.	Pharmacare	Powercon Co.	Techco, Inc
Consumer packaged goods	Consumer packaged goods	High tech	Healthcare delivery	Raw materials processing	Pharmaceuticals	Industrial control systems	High tech
Multiple goods	Capital equipment	High-performance components	Medical products	Raw material	Legal services	Electronic assemblies	Custom high tech electronic assemblies
				Significant price increases and tight supply			
						Parts short- ages and very long lead-times affecting com- pany's production, efficiency, cost and its service to customers	
	New customer requirements in emerging markets affecting formula- tion, packaging and production volumes		Pressure on healthcare costs				
		Create a new high technology com- ponent supporting development of new product system					
Get the company's share of cash gen- erated from acqui- sitions of suppliers					Fix problems uncovered in an internal audit. Begin imple- menting advanced procurement practices used elsewhere in the company and by competitors		Rationalize supply base after a series of acquisitions
	Create global equipment sourcing strategy and use China- based suppliers as leverage against incumbents in the west	Maintain alterna- tive suppliers in the market for when the new component design matures		Global sourcing, backward integra- tion, price index market intelligence	Directly source ancillary services		
		Migrate to single design standard over time	Reexamine and modify product sourcing and specification deci- sions based on patient outcomes and TCO	Specs rational- ization, TCO modeling	Change basis for payment from bill- able hours to cost per deliverable		
	Use equipment supplier's knowl- edge of local markets to guide product formula- tion and raw mate- rials sourcing	Jointly design component with supplier					
	Bring new produc- tion lines up faster				Implement annual fixed fee targets and set up sav- ings/overrun sharing with law firms	Focused supplier improvement effort to improve on-time perfor- mance of a spe- cific supplier with on-site Six Sigma and executive engagement	Rationalize supply base, then collabo- rate to improve- ments, tech- nology, quality, testing and sup- plier operations improvement
Monetize the value that the company brings to smaller suppliers by tap- ping into their increased market capitalization		Increase market share/revenue based on tech- nology lead					

creation. These strategies are frequently evaluated in terms of meeting overall business unit and/or product line goals and financial return on investment.

Additionally, highly talented supply and other functional personnel, including executives, were typically engaged in VFS strategy creation and deployment. The complexity of these strategies required creative, talented people who could influence other key decision-makers to commit resources and support the strategy.

These VFS strategies also require a holistic set of measures to evaluate success that are significantly related to the success of the business versus traditional price improvement measures and typical performance expectations of supply.

Finally, the role of supply management varied from strong leader to participant in VFS strategy development and execution. It was obvious that supply could not create and lead all efforts, but should play an "appropriate" and influential role based on the situation.

These and other enablers are discussed further in Chapter 5.

Chapter 3: Examples of Value Focused Supply Strategies

Perhaps 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 companies created value in four increasingly sophisticated ways — eliminate value leakage, increase current value, create tomorrow's value, stretch for added value — as illustrated in Figure 3-1.

In this chapter, we discuss each level of sophistication and dimension of value. Short examples from the research help illustrate the points. The case studies in Appendix A provide additional detail on the cases.

Eliminate Value Leakage

The first level of value that VFS can provide is to ensure that the company is not losing value from a key category. On the revenue side, this means protecting revenue by focusing on the quality of the goods or services being bought within the category as well as the stability of supply, for example availability, lead time duration and predictability.

Powercon found that it had to eliminate value leakage from a key category — 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 created unsatisfied customers. A focused effort to work directly with the supplier corrected the problem. Customer loyalty improved due to improved order reliability and the company gained increased flexibility in manufacturing, allowing it to respond more quickly to customer order changes.

Value leakage from cost often results from noncompetitive unit costs or ineffective demand and consumption management. Traditional actions associated with competitive sourcing, such as reducing the number of suppliers, leveraging companywide 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.

Several of the participating companies anchored their VFS approach by first reducing the number of suppliers for their key categories, both to increase leverage with them and to better focus their own category management resources. Once the supply base was rationalized, they chose to use competitive bidding to reduce unit cost for the more commodity-like portions of a key category. For more advanced or proprietary items in the category, they focused on helping suppliers reduce their own costs and then pass savings back to the company.

At pharmaceuticals manufacturer Pharmacare, legal services were traditionally purchased by the legal department due to the perceived technical complexity of the subject (protecting intellectual property and defending against lawsuits) and the potential to expose the company to risk. However, an internal assessment and external benchmarking by the supply organization found that the company lagged far behind its competitors in the use of best practices. By directly sourcing ancillary legal services that had previously been billed through law firms, adopting performancebased fee arrangements and negotiating alternative billing methods that pay firms by the task rather than the hour, Pharmacare was able to achieve cost savings ranging between 20 percent and 40 percent.

Another source of value leakage is working capital. Negotiating appropriate payment terms with suppliers — and then taking advantage of them — helps keep

Figure 3-1

Value Focused Supply strategy goals are holistic



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.

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.

Finally, there are ways that value can leak from the intangible assets of the business. The reputation of a company can be severely damaged by supplier actions, especially around key supply categories. Recent safety recalls include contaminated or intentionally mislabeled food ingredients that caused illnesses and deaths, as well as poorly designed or defectively made consumer electronic components that posed electrical or fire hazards. When child labor scandals surface, the resulting media firestorm causes major embarrassment to manufacturers and retailers at a minimum, and can result in long-term damage to a brand. Use of uncertified or counterfeit parts can also lead to embarrassing media coverage as well as lawsuits. Each of these circumstances can arise as a result of improper screening, selection and management of suppliers.

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 value. Instead, as participant companies have demonstrated, value creation begins by adding to revenue, attacking costs broadly rather than on a unitprice basis, making better use of fixed assets as well as working capital and improving the company's image in the eyes of customers. A key difference between preventing value leakage and creating value is that those actions to achieve the former are more prescriptive and generally applicable across the entire spend base. The latter calls for actions that 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. Healthifoods was able to enhance market share in emerging markets by using supplier market intelligence to develop products that fit local customer tastes.

Several participating companies emphasize reduced total cost of ownership as a gauge of the value that they obtain from key categories. They actively support and work with suppliers to streamline operations and cut waste.

Techco reduced costs for a key category by more than 10 percent while also improving on-time delivery and quality. Early supplier involvement in the design of custom components has improved manufacturability and lowered its costs. By implementing a common testing architecture with suppliers and locating testing equipment on-site at suppliers, both testing time and quality of testing were improved. Additionally, yields increased by 20 percent.

In the case of ComCo, a more collaborative working relationship style with its chosen suppliers has allowed it to put engineers on-site at suppliers to help them improve processes (e.g., lean and quality). Conducting workshops with suppliers to identify cost reduction opportunities has also proven successful; a recent effort resulted in a 15 percent drop in costs. ComCo also sponsored best practice sharing among 50 key suppliers, including site visits among non-competing suppliers to showcase manufacturing practices. The company also makes third-party manufacturing research centers available to suppliers to improve manufacturing processes and conducts cross-functional workshops with suppliers to share strategies and agree upon actions to improve performance.

In some cases, companies have increased current value by making better use of their global network of fixed assets. At Metropolitan, collaboration between procurement and manufacturing led to rationalization of specifications for a key commodity across the company's manufacturing facilities. By deploying a global optimization model to balance specification change costs, freight and storage costs, and material pricing, Metropolitan achieved operating flexibility and improved asset productivity, along with better pricing for the commodity.

From the standpoint of intangibles, rather than just protecting the corporate reputation from supply-side

threats, some companies have actually enhanced their reputations (and those of suppliers) as a byproduct of VFS. Bigtru received a prestigious automotive supplier industry award for co-developing a new alloy for a key part with one of its key suppliers. The company earned the award for innovations in new products or services that have a significant market impact and act as "game changers" in the automotive industry.

Create Tomorrow's Value

In addition to creating value based on today's set of products and services, a company can also use VFS to recast both how it and its suppliers create value in the future. This includes actions like leveraging supplier knowledge and insights to identify consumer and enduser marketplace needs to help create unique value for those markets. It also includes taking advantage of the supply base's technology capabilities to gain competitive advantage in new product, 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. It gained market share from the new part, and 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 over its competitors by as much as three years.

HiTech was developing a new higher performance end product. It enlisted a key category supplier to codevelop a brand new component that could match the performance and design needs of the end product. Close integration in the design and development work helped the company bring the end product to market a full year ahead of competition. The company's market share rose from 30 percent to 50 percent in the product category, while the supplier gained as well, seeing its market share in the product category grow to 60 percent.

Similar to the VHS/Betamax face-off in the early days of home video recording, the media and entertainment industry recently saw the emergence of two new competing technologies with the likelihood that only one would gain mass acceptance and become the industry standard. Beyond just meeting design and cost goals, Apollo, a media and entertainment company, created packaging that helped unify the adoption of a consistent look and feel for a new entertainment product across a number of companies that used Apollo's chosen technology standard. This in turn helped promote the acceptance of the new technology among both consumers and retailers. In the end, technology used by Apollo won out in the marketplace, generating significant additional sales for Apollo.

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.

ComCo is in the design phase of its next generation of power systems. Energy consumption and emissions, along with total operating cost to customers, will be key selling points. For a crucial component, early supplier involvement in design helped to eliminate an entire section, avoiding both material and labor costs for the component.

F&B combined several approaches to create a valuefocused strategy for a key commodity. It simplified product specifications and found ways to reduce use of a key ingredient. It also assigned volumes to suppliers based on its fit with each supplier's "sweet spot" of capabilities, which allowed suppliers in some cases to exit business that did not fit well, helping them become more efficient. It also developed in-house capabilities to process/manufacture some ingredients to increase its knowledge of the processes in use by suppliers. Overall savings from the effort totaled 12 percent. Much of the savings was plowed back into advertising, generating a significant sales lift; the subsequent pull-through of ingredient sales benefited the supplier partners as well.

Duraman has a strategic goal to be the low-cost producer by fully leveraging its scale. Its VFS approach for raw materials was integrated into the broader corporate effort, which included component architecture management (component standardization and governance rules that would reduce the complexity of the products it manufactured), raw materials standardization (to reduce costs early in the value chain) and raw material value management (to unearth supplier and material alternatives that could reduce design complexity and to develop sourcing strategies aligned with the complexity reduction strategies). Cost savings ranged from 5 percent to 20 percent, and inventories were reduced by 15 percent. Companies can create value for the future by working with suppliers to rationalize/optimize the asset structure across the value chain. For example, this can by done by eliminating duplicate assets, outsourcing or insourcing assets to achieve scale or cost advantages, and repositioning assets geographically to match market needs or to mitigate risk. The strategies employed by Metropolitan and Techco addressed these themes.

Another way to create future value is to tailor assets to meet the specific needs of growing markets and products. From a VFS perspective, this value can be created from those capital equipment categories that a company buys itself, as well as from rethinking the asset structure that supports the other key categories it buys and uses.

Healthifoods 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. It 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, the company found that the local suppliers provided knowledge of local consumer preferences that helped it to improve product formulations and guide sourcing for raw materials best suited for those formulations.

One important, albeit intangible, way to create future value is by ensuring that supply strategies support the company's sustainability goals. Green innovation for new products and services, strategies for gaining longterm access to sustainable sources of materials, and programs to ensure and cascade regulatory compliance along the value chain all play a part. ComCo is working closely with its component suppliers to create the nextgeneration high-efficiency power systems in demand by its customers. It will use less energy, resulting in a reduced carbon footprint and lower total cost of operations. At Healthifoods, new capital equipment purchases take into account full life-cycle costs, including sustainability considerations like energy and water use.

Stretch for Additional Value

As the previous examples illustrate, our research found several examples of how companies are 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 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 were 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 control. It 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. Eventually, however, the window of opportunity closed as demand in the customers' own markets slumped and orders for new plants and equipment dried up.

Globalgoods was already well down the path to creating more value from its key categories and supply relationships. Sourcing, supplier consolidation and supply chain integration were helping to keep costs in line. New product innovations from external sources were driving additional revenues. Yet the company believed that there was more value to be had. It recognized that there were several smaller suppliers in

its base for which the company represented a valuable and sizable source of business. A number of these suppliers were owned by private equity firms or public companies that could potentially look to spin off the businesses. The company is in the early stages of screening and negotiating with the owners of these small businesses to monetize what Globalgoods' base business means to the value of the small firms. Already, agreements are in place with two suppliers to provide Globalgoods with additional revenue, in the form of equity value rebates, based on the supplier's market capitalization and the level of business it does with the company. Negotiations are under way with two other small suppliers to issue warrants to Globalgoods that could be exercised when the supplier is sold or spun off.

With respect to cost, one avenue toward additional value is to use the supply markets to support the strategic reshaping of the company. This could include creating a more flexible cost structure to increase responsiveness to changing market conditions at a lower cost and supporting major geographic sales expansion outside of traditional markets. It might also include restructuring relationships, more closely integrating within the value chain and sharing risk in different ways.

Carco's product strategy greatly increased the variety of parts needed from tier-one suppliers, in turn increasing the number of different tools required to make them. In the automotive industry, toolmaking is often considered a commodity. Carco "broke the mold" by closely integrating itself with material suppliers, toolmakers and first-tier suppliers for the benefit of all parties. By changing tool designs to accommodate model variations, switching to aluminum alloy tooling for selected parts and improving toolmakers' capabilities, Carco dramatically cut tooling costs and lead times as well as tier-one-supplier processing times. The tooling companies became more competitive as they transformed from commodity businesses to value-added contributors to Carco's value chain.

At Meditrend, a healthcare provider, increased integration of the entire healthcare delivery system is viewed as a way to deliver better patient outcomes at far lower costs. The company is in the early stages of holistically modeling its medical processes and procedures. Specific equipment and products used in the procedures are being evaluated, along with factors such as time and cost to perform a procedure and patient recovery and longer term health outlooks. The company believes that the findings from the modeling will help it standardize products used and gain added leverage with suppliers. In the future, Meditrend envisions performance-based supplier contracting tied to how a supplier's products affect outcomes and costs. The ability to provide better outcomes at lower costs should also help it drive revenues as healthcare management in the United States comes under greater scrutiny.

Eliminating unneeded assets along the value chain is yet another way of creating value. Techco was able to eliminate testing processes and equipment at its manufacturing locations after it made suppliers fully accountable for final testing, cutting out duplicate assets. By reducing product complexity, Duraman reduced the number of product SKUs and inventory in the supply chain

Lastly, a company can obtain additional intangible value by including ways to block competition 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 blocked competitors from setting up competing supply chains. Bigtru, which codeveloped a new alloy, has patent protection over it, further delaying the market entry for its competitors' alloys.

Observations

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, it involves strategies centered on collaborating with specific suppliers of key categories to unlock even more value.

Additionally, 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 spin-off benefits related to assets or intangibles.

Finally, a clear pattern emerged. The more sophisticated a VFS approach, the stronger the linkage required among 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.

Chapter 4: A Framework for Implementing Value Focused Supply

The examples in Chapter 3 illustrate a wide range of VFS strategies in place at the companies studied. For other companies interested in pursuing VFS, two questions need to be addressed by executive leaders and supply management. First, when is a value-focused strategy needed to maximize overall competitive benefits? Second, what approaches and/or processes are required to develop and implement these strategies? The answers to those questions are examined in this chapter.

When Is a Value-Focused Strategy Needed?

Value Focused Supply strategies are required to develop solutions to problems (protect value) and to create value by taking advantage of current and future opportunities to improve the competitive position of the business and product line(s). Figure 4-1 illustrates problems and opportunities.

Value protection is most typically required when a company is encountering major problems (for example "unintended acceleration at Toyota) and/or competitors are changing the nature of competition through improvements that customers value, such as increased flexibility or service. Companies will therefore have to react to these problems or changes and improve strategic supply performance, which will affect the end customer. Many value protection strategies are reactive but can be built upon proactively.

Bigtru applied VFS strategies to develop a new super alloy in reaction to market conditions and rapidly increasing raw material prices. As a result of the success of this "reactive" VFS initiative, the company began a proactive effort following VFS approaches to develop a next-generation component to increase engine power. F&B applied VFS strategies to some ingredients in reaction to a companywide need for margin enhancement. As a result, VFS is now being applied to additional purchases, with a focus on proactively achieving supplier innovation.

Techco applied VFS strategies to rationalize its supply base for advanced electronics purchases to improve quality as well as delivery performance and predictability. As an outgrowth of this initial effort, Techco is now developing VFS strategies with a smaller number of suppliers to bring them into the product design process earlier to achieve more effective designs and innovation — all at a lower cost.

In contrast, the creation of value requires that the company proactively and creatively identify conditions and opportunities present in the business and supply network that, through innovative VFS strategies, enable the company to establish a superior competitive position in the end-customer marketplace and/or a superior financial position. Examples of this sort of value creation include the joint development of a new technology with a supplier for a subsystem or offering an automobile that enables broader sync applications than competitors.

In Chapter 3, the Powercon, Techco and ComCo examples point to cases in which companies had to develop VFS strategies to protect value, while Apollo, Bentham and Globalgoods provide excellent examples of the creation of value.

High-Level Systematic Processes Required for VFS Strategies

Figure 4-2 presents the processes required to develop and implement VFS strategies. Key points of

When is a Value Focused Supply strategy needed?

A VFS strategic focus is required when:

• Supply problems are:

- Impacting end customers
- Unfavorably impacting income and balance sheets
- Negatively affecting goods/services development

Overall, the company competitive position must be protected.

VFS conditions and opportunities exist in the:

- Business,
- Supply market,
- Supply chain/network, and
- At customers

that lend themselves to supply strategy innovation and <u>value</u> <u>creation</u>, resulting in superior customer market position and financial performance.

differentiation from traditional sourcing approaches that illustrate VFS are also shown.

The processes or approaches shown in Figure 4-2 identify systematic and detailed approaches required to succeed at VFS. In addition, those critical approaches highlighted with an asterisk (*) suggest the major differences that exist between competitive sourcing and VFS. These approaches place increased emphasis on data/information collection and analysis, increased and laser-like focus on those strategic purchases that truly impact business success, holistic value goals and metrics beyond price/cost, creative supply strategy development, and companywide/supplier teaming for both strategy development and implementation.

Understanding Customer, Supply Markets with Alignment and Linkage between the Company's Business, Product and Technology Strategy

Implementing VFS requires 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. It also 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.

Ultimately, value to the consumer translates into value to the company in the form of revenue. But VFS 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.

Deep understanding of customer and supplier markets, and how the industry and the company compete currently and in the future is also necessary. This understanding is required for the company to align and link its business, product and technology strategies. It is also necessary so that the company and supply management can correctly establish which purchases are strategic to the customer and how value can be created.

Specifically, the company must establish current and future competitive conditions in both the customer and supply markets, and potential rates of change in both. Included is the segmentation of customer markets by class of customer and geographies to identify value differences.

High-level process for Value Focused Supply strategy development suggests key differences from traditional approaches



Bentham's marketing department was asked to develop future forecasts for a particular type of highly specialized equipment used in the industry. Based on detailed forecasts by customers and replacement cycles, it became obvious to Bentham's supply management department that a significant bottleneck would result in lengthening lead times, with possible loss of revenue to customers. Therefore, the new and innovative VFS strategy was developed to reduce equipment lead times and capture market share.

Linkages and communication among those responsible for business, products, technologies and supplier strategies also must be established so that a consensus can be developed about what customers value and the enabling strategies needed.

F&B's VFS ingredient strategies were driven by the need to improve margins. Executives, supply, manufacturing, finance and marketing worked in tandem to identify what customers truly valued, then developed the supply and manufacturing strategies to achieve required margin increases. Typically these two points are not fully developed for traditional sourcing, which has a primary focus on price/cost.

Determine Purchase Categories That Are Strategically Important to the Company and Required Value

VFS requires that companies establish those purchases that are strategic and have the most impact on their financial and market performance. A two-stage screening process is required, as shown in Figure 4-3. The first stage establishes which purchase categories are truly strategic to the business based on their impact on product sales, return on investment, profitability and/or significant problem resolution. The second stage in the screening process enables a more granular approach to determining, for those categories that passed through the initial screen, which purchase categories have the potential to generate the greatest value from a VFS effort and which have the highest likelihood of being implemented. Figure 4-3

Determining purchase categories for Value Focused Supply strategies requires a screening process



Detailed analysis is required to fully determine to which purchase categories VFS should be applied. This screening, depth of analysis required and direct linkage of the strategic category to customer demand and requirements go far beyond traditional sourcing.

Understanding Macro, Micro Details of the Strategic Purchase Categories

To apply VFS, two categories of data are required. The first is the data required to establish whether a purchase category is truly strategic and impacts business. The second set of data required for those purchases that are most suited to VFS strategies will now be reviewed. Both are highly interrelated and could be developed somewhat concurrently.

The data/information and analyses required to create innovative value-focused strategies should include analyses of customer purchase requirements, industry/supply markets and suppliers. Examples of the types of data required are shown in Figure 4-4. Based upon the data collected, a number of approaches should be used in strategy formulation, including:

- Determining the impact on customer needs
- Understanding purchase patterns
- Mapping the value chain and rationalizing work and bottlenecks
- Modeling costs, cost drivers and the value chain, with improvement levers identified
- Analyzing cost-to-outcome considerations for the category and strategic suppliers
- Performing segmentation analyses that support VFS strategy variations for the purchase
- Determining total cost of ownership
- Undertaking risk/reward analyses
- Benchmarking competitor supply strategies
- Examining revenue generating opportunities

Analytic approaches such as these are described further in Chapter 5, which focuses on enablers. The differences between traditional sourcing and VFS are centered upon the depth and breadth of data gathering, its cross-functionality and the analyses conducted. VFS requires much more of each. Figure 4-5 illustrates macro value chain network analysis/mapping.

Figure 4-4

VFS strategies require a wide range of data

Customer Focus

- Price to value of products/service sold
- Confidence in our company's value chain performance
- Product/service attributes critical to success

Purchases

- Specifications
- Cost and cost drivers
- Technology roadmaps
- Rate of technology change and the next generation
- Usage (historical, current, future) by company location, markets, etc.
- Annual spend (\$)
- Product life cycle
- Usage patterns

Supply Market (Tier 1.....n)

- Degree of competition, competitors and how supply industry competes
- Price trends and drivers
- Major users and trend
- Government regulations
- Supplier and product cost structure and drivers
- Supply industry dynamics, i.e., technology, M&As, etc.
- Value chain characteristics

Supplier Analysis

- Assessment of business strength over time
- Risk
- Capabilities assessment
- Historical and projected performance

Carco provides an excellent example of an automotive OEM working collaboratively with the supply network to create value. By working closely with tier-one component suppliers, toolmakers and material suppliers, the company was able to unlock value from the tooling category by developing tooling that had common characteristics across products that could also be quickly tailored for a specific end product. Carco had established supply network and value stream maps showing the quality, technology, delivery and cost-driver relationships between the company and its suppliers' business processes and technologies, and how efficiencies could be improved.

Set Holistic Value-Focused Goals for the Category

Value goals are far more holistic under VFS than in traditional price-/cost-focused sourcing. Figure 3-1 in the previous chapter illustrated the broad range of goals covered by VFS. Overall, these goals must be aligned and linked to how the end product creates value for the ultimate customer. Weightings for these goals also must be established to reflect the importance, or lack thereof, of certain attributes. For example, at F&B it was determined that the customer did not value multiple shapes of an edible product. The number of shapes was reduced by 75 percent, with positive impact on product margins.

Even though price/cost will continue to be of significance, its weighting in VFS strategy development for strategic purchases can vary broadly and will be far lower than 100 percent. Packaging innovation and new technology at Apollo and HiTech, respectively, were the primary factors considered in developing value-focused strategies, not price.

Evaluate and Select Strategic Supply Options

Critical to the success of VFS, based on analysis of broad and deep supply- and customer-focused data, is the need to create innovative supply strategies for the VFS purchase category. Doing so requires going beyond traditional sourcing strategies of volume concentration, re-sourcing based on competitive bids, aggressive negotiation and low-cost country sourcing. Figure 4-5

Value Focused Supply requires in-depth supply value chain/network analysis and understanding of value creation



VFS strategies require companies to think broadly and marshal all resources necessary to creatively develop and implement longer-term strategies. Figure 4-6 highlights how VFS strategies require "thinking outside of the box" by fully evaluating and then changing the way the supply market operates and/or changing market dynamics, as well as changing what is purchased and the way in which the company works with suppliers.

Metropolitan, Bentham and Pharmacare each found ways to change the rules about how supply markets operated, creating significant value for their companies. Duraman, F&B, Apollo, Bigtru, HiTech and Meditrend redefined what they were purchasing, bringing in greater value from their expenditures. VFS strategies at Healthifoods, Globalgoods, Carco, ComCo, Powercon and Techco illustrated how a different approach toward working with suppliers could unlock and, in many cases, create new sources of value.

Select and Implement VFS Levers

Implementing VFS strategies requires recognition that the VFS levers shown in Figure 4-6 also could be pulled (i.e., strategy options selected) for some traditional sourcing approaches. However, the company needs to recognize that inappropriately applying complex and value-focused strategies may not result in appropriate returns for non-VFS purchases or be too difficult to implement because of required resources and executive support.

Effective VFS strategies require appropriate identification of strategic purchases for VFS and then creation of holistic value-focused goals and appropriate strategies for implementation. It is important that these VFS strategies be cross-functional and frequently crossenterprise, with the support of C-level executives for successful implementation and results.

Robust value-focused strategies require companies to think "out of the box" of traditional sourcing approaches



- Process integration
- Joint cost reduction
- Relationship management
- Reward for performance
- Target costs/price
- IP management

Developing VFS strategies requires creativity in strategy development and systematic VFS approaches and processes. In addition, the research with the 15 companies identified a consistent set of VFS enablers required for success, which is discussed in Chapter 5.

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Chapter 5: Enabling Value Focused Supply

In Chapter 2, we explain how the more advanced VFS strategies followed two themes:

- There was a sharp focus on value alignment, beginning with a deep understanding of value from the consumer or end-user perspective. That understanding was carried back through the value chain and outward to the supply base, forming the template for aligning resources to deliver value.
- There was also a holistic view of value creation, both in terms of the potential sources of value and the actions needed to secure it.

Underpinning these two themes are seven enablers, as shown in Figure 5-1.

As the examples in Chapter 3 illustrate, the strategies used to protect or create value through supply differ greatly across the 15 companies studied. Even though the specific strategies were tailor-made to fit each company's business strategy and market conditions, there were common elements that enabled companies to conceive, develop and implement the VFS strategies. Those enablers are explored in this chapter.

While individual companies used these enablers in different ways and to different degrees, several common characteristics of successful VFS implementation emerged. The research also identified areas where improvement is needed to further embed and extend VFS in an organization.

Executive Engagement

Value Focused Supply is a fundamentally different approach than traditional supply management. It requires that the company as a whole works together to find and leverage supplier capabilities and marketplace opportunities that will create value. Developing and implementing VFS strategies require knowledge, cooperation and resource commitments that go far beyond the supply organization. By its nature it is crossfunctional, and requires deep linkages into the business unit strategies for product/service and market development. Executive engagement across the organization is a must.

Executive Leadership

Throughout the interview process, companies pointed to the requirement for top-level executive leadership to ensure that VFS strategies are developed, funded and broadly supported across functions and enterprises to achieve business unit objectives. How this occurred took multiple forms.

Bentham's success in developing an alternative supply chain for a specialized component depended on strong executive engagement throughout the process. Crossfunctional discussions revealed the spike in demand for the end product and the supply constraint for the component that was driving long lead times. These discussions also brought out the value creation potential for customers by making their plants operational six months earlier if Bentham could develop an alternative source. Ultimately the supply strategy came to be viewed as a business strategy by Bentham's senior executives.

Bigtru's executive leadership team has significantly increased its attention to supply management in the past several years. Prompted by a keener understanding of the criticality of key categories to the company's end products and the risks of limited supply options, the executive team funded and organized cross-functional teams to pursue VFS. Duraman's VFS program came about as the direct result of a senior executive's mandate to become Figure 5-1

To develop and implement their strategies, participating companies employed seven types of enablers



Individual companies used these enablers in different ways and to different degrees

the cost leader. At Metropolitan, the VFS program had the direct sponsorship of the CEO and executive team, and the support of the CEO to take on risk.

Recognition of and Commitment to Create Value through Supply

A thorough understanding of the business strategy and value drivers is the basis for linking supply to competitive business strategy. For those key purchase categories that would best benefit from VFS, identifying and gaining agreement on the category's strategic importance and value creation potential is the starting point. Top-level executive management must be just as attuned to creating value from supply as it is toward delivering value to customers — indeed, they are two sides of the same coin.

Minus top-level recognition and commitment, supplyrelated value creation opportunities may be stymied. In several cases in this study, supply was unable to gain significant results on its own until corporatewide initiatives created the platforms/channels to gain visibility and resources, and to enable collaboration with others.

Over several years at F&B, supply management identified a portfolio of improvement projects that could be implemented relatively quickly. But these projects were on hold, requiring business unit buy-in and cross-functional teaming for which the company was not yet ready. When a corporate-wide mandate for margin improvement finally opened the floodgates, supply was ready to meet the challenge.

Cross-Functional Understanding of Value Opportunities in Supply

Each leader of company functions — finance for control and financial assets, human resources for people assets, marketing for brand assets, engineering for technical assets and manufacturing for productive assets — must have a basic awareness of the source and use of strategic value for existing or future spend categories that affect the corporate assets for which they are responsible. At Duraman, the cost leadership mandate led to crossfunctional teaming between engineering and procurement based on a "common agenda" for the two groups. It required collaboration across lines of business on components and commodities common to multiple business units.

At Healthifoods, cross-functional planning gave procurement visibility into the company's three-to-fiveyear market penetration/growth and related capital expenditure plans, allowing it to develop a matching equipment sourcing plan.

When it decided to cut its supplier list for a key category by more than 80 percent and focus the business on a few key suppliers, Techco depended on strong sponsorship by engineering, technology, quality and supply chain executives to set direction and help enforce policy. To boost acceptance by the engineering community, the program was managed as a joint supply chain, engineering and operations effort.

Business Unit Ownership for Results

To shift the conversation to multiple dimensions of value, the business unit must lead a coalition of parties such as procurement, marketing and operations that have historically had separate interests. Sometimes this requires addressing (or preemptively heading off) crossbusiness unit or cross-geographic conflicts when multiple units are involved. For example, the supply management organization at HiTech had to develop an integrated strategy for working with a small set of suppliers in a common supply market while balancing the unique needs of each business unit's end market, which ranged from low-cost, reliable components to the latest in advanced technology.

Governance Process

Related to all of the elements above is the need for a governance process to guide the efforts and resolve conflicts in the short term. At F&B, a governance process to establish and monitor VFS opportunities was led by the divisions, which established what customers valued by product line. The divisions worked with supply, manufacturing, logistics, technology and others to determine which purchase categories were most likely to produce higher margin returns based on possible efficiencies in the way in which value was provided to customers. This portfolio of high-opportunity projects was monitored for progress and results, and if projects were falling short of expectations they were redirected to higher probability/payback efforts.

Similarly, governance processes are required to embed improvements in the long term. Duraman continues to work on its governance process to ensure that complexity does not creep back into its product designs.

Another important part of the governance process is to ensure that the needed resources are available to pursue VFS strategies. Several companies in the research found that dedicated resources had to be added to create and execute VFS strategies for key purchase categories.

Value Chain Goal Alignment and Measurement

Holistic supply value metrics need to align with customer, business unit and supplier competitive objectives and strategic plans. Moving forward, the key challenges will be to develop and agree upon these nontraditional metrics and create the means for data collection and validation.

Developing Value-Based Metrics

In general, the participating companies have wellestablished metrics for traditional dimensions of supply value, such as purchase cost, inbound quality and ontime delivery. Several extend cost measurement to include total cost of ownership, bridging into manufacturing, distribution and even after-sales service.

However, these measures do not begin to cover the range of factors that make up value in the eyes of consumers or end users. As Chapter 1 describes, they perceive value in terms of benefits to cost, with benefits ranging from the relatively easy-to-measure functionality and performance to far more subjective ones based on personal preferences and needs. To complicate the task even more, different segments of consumers or end users can place very different weights on the various benefits.

Developing useful metrics to measure value from supply means having a clear line of sight into what the consumer or end user values, then converting those insights into metrics to gauge supply contributions to value creation. (See "Value Chain Mapping" later in this chapter for further discussion of that topic.) For example, the consumer packaged goods companies in the study are connecting consumer desires for healthier, lower calorie foods back through their product development processes and into the supply base. With the needs of its end users in mind, ComCo is designing its next-generation power generation equipment to be both green and less costly to own and operate.

VFS strategies often enter uncharted territory from a metrics standpoint. Two participant companies weighed in on the same challenge: Traditional measurement systems make no provision for counting and rewarding company-supplier efforts to design out costs upfront. Instead, the behavior they encourage is for the company to later change the design and then claim the cost savings. Similarly, few companies have developed metrics that measure the impact of supply strategies on increased sales or on product and service innovation and even then, these tend to be ad-hoc or project-based measures outside the formal accounting systems.

As VFS strategies become more robust and far-reaching, companies will be tested even further as they seek to design and gain agreement on value measures. Consider the challenges of developing metrics that support Meditrend's VFS strategy to shift from a total-cost-ofownership viewpoint for procurement to a holistic patient outcome view for the entire healthcare delivery system.

Establishing Joint Goals across Business Units and Functions

Joint objective setting and joint accountability for results between supply and the affected functions and between supply and the business units played a central role in successful implementation of VFS strategies. This involved ensuring that short and longer term value goals were linked to business strategy and financial metrics and that functional strategies and goals aligned with overall business plans. To help prioritize and reinforce performance expectations, it also included integrating value creation metrics into the evaluation and reward process for business and functional units, and for individuals.

Goal alignment throughout ComCo is a core element of the company's three-year transformation program for supply. It has put in place processes that integrate functional strategies and goals with the top-down "overall business development plan," in which customer requirements flow into the business strategy, which in turn flows to functional strategies. VFS strategies go before a cross-unit, cross-functional strategy board for buy-in and sign-off. Cross-functional teams from procurement, manufacturing, manufacturing engineering, quality and development share goals and accountability for project results.

At Duraman, cross-functional alignment played a key role in the success of the VFS strategy. The joint engineering-procurement team had accountability for governance of raw materials specifications globally; all team members shared the same objectives for standardization, cost reduction, project implementation and governance.

Aligning Goals along the Value Chain

Many of the studied companies' VFS strategies relied on

supplier capabilities to complement and supplement the company's own resources. Although the suppliers, as separate businesses, had their own strategies and motivations, the companies in our research found ways to align suppliers' goals with their own to benefit both parties. Common metrics between companies in the supply chain helped to enhance the VFS focus.

Powercon found that an important supplier misunderstood its performance requirements due to misaligned performance metrics. Harmonizing metrics between Powercon and the supplier allowed clear communications expectations, which led to agreement on goals and formed the basis for stemming major value leakage.

Carco's VFS approach to tooling required goal alignment among three parties: the toolmakers, parts suppliers and Carco itself. The company and its part suppliers wanted local tooling sources that were competitive on cost, quality and delivery, and also wanted to maintain a local pool of toolmaking know-how. The tool shops had complementary goals — become globally competitive while maintaining local operations, gain know-how about improving operations from Carco and suppliers, and stabilize business levels by becoming preferred suppliers for future business.

Certifying Performance and Results

Several of the participating companies pointed to the importance of having independent validation (outside procurement) of the performance and results of their VFS strategies. This was due to the cross-functional nature of the efforts and the need to develop and use nontraditional measures, along with the desire to counter skepticism. For example, at ComCo the finance department takes the lead in measuring value, as it also does at Globalgoods (in the latter case, finance also helps ensure that value does not "leak" from the supplier's books before the company is able to capture it). At Techco, supply management proactively engages finance to audit and verify benefits, adding credibility to the process.

Supply Market Understanding

Deep supply and demand market understanding, both upstream and downstream, is required to develop breakthrough VFS strategies. This includes understanding supply market structure, economics, supplier capabilities (including determination of technology leadership), capacity bottlenecks and the most effective places to position work within the value chain. It also includes understanding the day-to-day dynamics of the markets, including supply-demand balance and pricing.

Gaining Deep Market Insights

Understanding the supply market is a basic step in traditional sourcing. But for the VFS study participants, gaining a much deeper understanding of market trends both on the end product side and the input side sometimes uncovered strategic threats or opportunities, providing the impetus for bold strategic moves.

Bentham extensively researched the upstream supply chain to understand supply-demand balance and choke points. It coupled this with detailed research into substitute sources of supply for key value-add steps. These were then crafted together into an alternative supply chain that helped Bentham overpower its competition.

Globalgoods recognized that owners or investors in its smaller suppliers were realizing significant economic value due to their relationship with the company. By developing an in-depth understanding of selected suppliers' capabilities, ownership structure and economics, as well as the industry structure and how the supplier creates value, Globalgoods determined that there were opportunities for it to share in these economic benefits.

Understanding Day-to-Day Dynamics

Especially in commodity or commodity-like markets, up-to-date market information is critical for some VFS strategies. At Metropolitan, having an accurate understanding of the current supply-demand balances and pricing proved vital to its strategy of leveraging regional arbitrage opportunities against its global footprint. It increased market intelligence from being in the local markets "every day," while improved transparency and accuracy of pricing came from working with market surveyors to improve the accuracy of published price indexes.

Collaboration Approaches

Collaboration and information transparency among customers, functions and suppliers at all stages in the value chain/network is required to maximize innovative VFS strategy creation and implementation. Establishing joint accountability and rewards for results helps pave the way.

Internal Collaboration

Repeatedly, internal collaboration proved to be a key ingredient in creating value from supply. Sometimes this took the form of collaboration across business units and geographies, but often it included cross-functional collaboration as well. As one participant put it, "Value gets dammed-up behind functional walls and you need funding and resourcing to break down the barriers." For many participants, cross-functional collaboration was key to rationalizing specifications and reducing total cost of ownership.

Key processes for which integration proved important included strategic planning, innovation and new product development, geographic market expansion and capital project management, along with the more traditional manufacturing and supply chain linkages. Not surprisingly, cross-functional collaboration most often occurred between procurement and product development, engineering or manufacturing.

At Apollo, the new package design would not have been possible without creative services and procurement jointly working with the supplier. The former brought consumer product design expertise, while the latter ensured both the commercial viability and the manufacturability of the design. Duraman married its engineering-driven complexity reduction effort with procurement's ability to search for alternatives and align material sourcing strategies with complexity reduction efforts, yielding a payoff bigger than either effort could produce on its own. For Metropolitan, close cooperation and involvement of procurement, plant management, technical teams and the business units helped the company optimize its sourcing and manufacturing strategies.

However, there were also examples of collaboration with other functions that unlocked value as well. Healthifoods integrated procurement into both the geographic market expansion process and the capital project management process. The result was equipment designed and locally manufactured specifically for developing markets, with the add-on benefit of creating an alternative supply base for its mature markets. By working cross-functionally, procurement, legal and finance at Globalgoods found innovative ways to tap into the value the company created for suppliers. At Pharmacare, supply management and legal teamed up to change the way the company buys legal services.

Collaboration and Process Integration along the Value Chain

In addition to internal collaboration, there were many examples from the research that pointed to the importance of collaboration along the entire value chain. Having strategic alignment/shared vision with suppliers was a critical first step, building upon the foundation of value chain goal alignment. From this jumping-off point, collaboration took on many forms. For some companies, the approach involved two-way sharing of strategies, plans, technology and other roadmaps with suppliers as a basis for longer term product planning. Others worked directly with suppliers to improve company-supplier processes, for example early supplier involvement in design, streamlining product testing and logistics, or to sharpen the capabilities of the supplier's own operations. At Techco, the willingness of both the company and suppliers to share technology roadmaps contributed to innovation and lower cost. The development of a common test architecture and the placement of test equipment at supplier locations also cut costs and time.

Carco collaborated with three tiers of suppliers aluminum suppliers, toolmakers and parts manufacturers — to jointly reshape its supply chain for injection-molded parts. In addition, it shared its expertise with toolmakers, teaching them process efficiency, lean manufacturing, benchmarking and design-manufacturing integration.

ComCo melded internal and value chain collaboration to improve both product design and manufacturing. Cross-functional teams included the procurement, manufacturing, manufacturing engineering, quality and development functions. It encouraged manufacturing best practice sharing across suppliers and made its manufacturing research centers available to suppliers to help them improve manufacturing all along the value chain.

Healthifoods brought equipment, ingredient and packaging suppliers together to jointly improve its overall manufacturing processes. Bigtru integrated its own design engineers with the supplier's. These new joint technical teams worked on-site at the supplier's facility to co-develop the new alloy.

Supplier Relationship Characteristics

Developing and maintaining strong relationships with suppliers of critical categories was vital to several of the VFS strategies studied. Positive supplier working relationships, based on trust, fairness, information transparency, capabilities and cultural alignment, increased the likelihood of gaining supplier value and building longer term and most favored customer positions. The companies we studied found that strategic suppliers would work collaboratively with their customers to jointly protect and create new value from their supply relationships, with the expectation that they would be rewarded for their efforts.

Three main characteristics of the company-supplier relationships — cultural match, valuing the incumbent, and trust and openness — led to successful implementation of VFS strategies.

Cultural fit played an important role in several of the relationships. For some, this meant that they shared a commitment to design and engineering excellence. For others, it was based on a shared vision of consumer/end-user needs and how to meet them. Still others looked for compatible management styles.

HiTech had several potential suppliers for its new component. Supplier selection for development of the new component was largely based on technical capabilities, coupled with a cultural fit between the company and the supplier based on technological/engineering excellence.

Building on existing supplier relationships that demonstrated how the company valued the incumbent supplier was often the foundation of VFS. Cultural fit was, of course, part of the equation, but this was also because the company already had a deep understanding of the quality, size and geographic fit of the supplier's capabilities with its needs. In several cases, participants invested in strengthening the capabilities of current suppliers rather than finding new ones. In this way they helped to ensure high quality and reliability from the supplier as a basis for further value creation.

Most of the relationships were based on a core of trust and cooperation between company and supplier, as the two parties shared information openly. They agreed to and worked to ensure joint accountability for results. They exhibited fairness by negotiating price based on current supplier cost and future improvements, sharing upside potential with suppliers and protecting intellectual property rights for both parties.

Apollo's relationship with its packaging supplier illustrates a strong level of trust and cooperation between company and supplier. Neither party was certain that the packaging design would be adopted as the standard for the new format, yet each trusted the other to act fairly if the design was chosen. Intellectual property attorneys shaped a fair agreement that protected both parties' rights. Once the design was chosen, price was negotiated based on an accurate understanding of costs and the two companies carried out joint efforts to reduce costs. Apollo also encouraged the supplier to license the design to others and get an additional revenue stream in return.

At Bigtru, the company selected an incumbent supplier to develop the new alloy based in part on its strong technical and engineering capabilities. But the closeness of its working relationships, coupled with a shared strategic vision of the importance of cost competitiveness, cinched the relationship. Their joint efforts paid off with leading-edge technology and valuable intellectual property shared by both companies. Unfortunately, Bigtru's awareness of the supplier's financial situation did not match its knowledge of the supplier's technical capabilities, as the supplier was driven into Chapter 11 bankruptcy proceedings by an industry downturn.

F&B's approach toward its key suppliers helped to foster VFS strategies in several ways. For example, in one important category the company evaluated eight incumbent suppliers and chose to partner with three essentially sole-sourcing each of three main types of product in the category. In addition to gaining business, these suppliers were in some cases allowed to opt-out of business with F&B that did not match the supplier's capabilities. Pricing is cost-based, with biannual contracts for guaranteed price in exchange for guaranteed volumes. F&B shares its consumer insights, enabling suppliers to better formulate ingredients to match consumer needs. Due to F&B's strategy of reinvesting procurement savings in marketing, the suppliers shared in F&B's revenue growth via additional sales to the company.

For years, Carco had a reputation as a leader in managing supplier relationships. Its emphasis on helping suppliers improve their own competitiveness laid the groundwork for its innovative approach to tooling. Rather than treating toolmakers as a commodity business, it helped those companies transform themselves into value-added contributors. Further, it continually looks for ways to share benefits with its supply base, as shown by its willingness to let suppliers keep the savings from using the new tooling for the life of the model.

ComCo faced a bit of a challenge when it began to engage suppliers regarding its VFS strategy. Past actions had created the perception among suppliers that ComCo had treated them unfairly. While still a work in progress, the company has made great strides by focusing on ongoing relationship management with key suppliers through the personal efforts of a new supply executive team. ComCo has become far more open with its suppliers, sharing elements of its category strategies. Value improvement workshops with suppliers are uncovering new opportunities that sat untapped under its former supplier management approach. At the same time, ComCo is expecting new behaviors from its suppliers. To participate in new product development going forward, suppliers are required to provide cost transparency to ComCo.

Multiple Touch Points

The companies studied frequently mentioned the need for multiple touch points between their organizations and those of suppliers to deliver added value from the relationship. In several cases, product engineers and designers worked side-by-side with their supplier counterparts to design in features for new products or to design out waste in existing ones. Working together, manufacturing engineers and quality experts streamlined shared processes using Six Sigma and lean manufacturing techniques. Top management-to-top management communications helped to ensure strategic alignment and build an environment of trust. In one example, top-to-top direct communications were the only way to break through the supplier's internal bureaucracy and get issues resolved.

Information and Analytical Capabilities

Earlier in this chapter, we discussed the importance of understanding the supply market in detail as a means to identify and capitalize on value creation opportunities. While this is important, gaining this understanding is only half the battle. Equally important is developing the information and analytical capabilities to understand purchase patterns in order to evaluate supply options and engage with suppliers on value creation opportunities.

Deep information and analysis based on comprehensive research about purchase spend patterns, price/cost drivers, total cost of ownership, risks, value maps and supplier technology roadmaps throughout the value network is required for effective VFS strategies. To analyze the complex trade-offs, cost-, operational- and risk-modeling capabilities are needed.

Understanding Purchase Patterns

Most companies studied have spend visibility and analysis tools in place. While these provide the basics needed to support the traditional sourcing strategies (e.g., supplier consolidation and price negotiations), they often lack the depth of detail to support more advanced VFS strategies. To support its complexity reduction efforts, Duraman found that it was necessary to develop information systems that provided design engineers with visibility into existing designs and component and materials specifications. This data helped guide product design and raw material choices that would add value rather than unnecessary complexity.

Pharmacare was able to peer through the historically opaque billing processes that external law firms used by analyzing the details of its e-billing system for legal services. Each invoice contained task-level detail tied to legal industry standard task codes that showed hours and costs. This detailed level of granularity allowed Pharmacare to move away from time-based payment toward fixed fees for routine legal tasks.

Mapping the Value Chain

Value chain analysis starts at a company's end products and services and works backward through the chain to identify where value is added or leaked. While few of the companies studied spoke of a formal value mapping process, many exhibited behaviors that indicated an informal approach was in place.

Figure 5-2 provides an example of a value map, which begins by segmenting the consumer/end-user markets, then understanding what each segment values in terms of benefits (key selling factors), costs (price point) and trade-offs. For example, HiTech knew that various segments had different needs and wants for its end products and also knew how much the components contributed to these needs and wants. Bentham recognized the value that early delivery of its specialized equipment would bring to end users.

The next step is to trace back the specific value-add steps both internally and back through to suppliers, looking at technologies employed, costs, capacities, geographic locations and other factors in order to evaluate capabilities internally and externally to deliver the needed benefits/costs. A company can then examine both competitive and value-based alternatives in the supply market to increase the value to the consumer/ end user, reduce the cost of delivering it — or both.

While the companies studied were able to conduct this value mapping informally on a situation-by-situation basis, the research team believes that companies that apply VFS analysis and strategies to their portfolio of key categories can benefit from a more formal approach to value mapping.

Analyzing and Modeling Options

Several companies, including Carco, Apollo, F&B and ComCo, have developed cost models that help them to understand suppliers' costs and predict how they will behave if conditions change. In addition to their use in negotiations, these models also point companies and their suppliers toward cost savings opportunities.

Other companies have developed broader models that look at systemwide impacts of changes to supply and other inputs. Metropolitan developed a standard total cost model to uniformly evaluate the cost impacts of changing specifications across its manufacturing sites. It coupled this with a systemwide optimization model to find the best configuration of sources and production to balance materials, production and logistics costs across the enterprise. Although still in early development, Meditrend's analytical model that relates a surgical patient's long-term outcome to the costs of the surgical team composition, techniques and medical supplies employed could help lead to breakthroughs in patient care.

Exchanging Information along the Value Chain

Many of the companies interviewed regularly exchange supply chain-related information such as forecasts, inventory levels, orders and shipments with their suppliers. This information exchange protects value by stripping out unneeded cost and unproductive assets. Some participants also use information exchange as a means to create value by helping to integrate design efforts on new products.

Several participating companies rely on a two-way exchange of technology roadmaps with suppliers. This helps each anticipate the future developments and investments of the other and also helps point out divergences while they can still be reconciled. At Techco, suppliers have direct access to an electronic library of drawings and specifications. This has helped cut Techco's cycle time for bidding on new projects, improved accuracy and reduced errors when winning designs went into production. Carco encourages the use of standardized tool design software along the value chain.

Organization and Human Resource Management

A supply organization capable of holistic value creation requires an organizational structure that fosters crossfunctional and cross-organization teaming. Further, it requires highly skilled, talented people with significant analytical and creative capabilities.

Globally Coordinated Category Management

Center-led organizations seem to be a key ingredient for success in VFS efforts, as this model provides global integration internally as well as a unified face and global reach into the markets. At several of the companies studied, key categories were globally coordinated across geographies and business units. In some cases, there was a global category leader responsible and accountable for the category across the enterprise. In other cases, regional leads had responsibility but operated as a networked team.

At HiTech, the supply management organization is built on the concept of centralized buying for categories used across business units. Global management of these categories allows for coordination of the strategy across business units. For Healthifoods, global centers of Figure 5-2

Value mapping links customer needs back through the value chain to supply options



excellence manage all supply chain aspects for key categories, including sourcing.

Skills beyond Traditional Sourcing

The skills required for VFS represent something of a step change from those needed for traditional sourcing. One supply executive we interviewed put it this way: "Skilled sourcers (like those so coveted in organizations circa the late 1990s through the mid-2000s) may lack the skills needed to manage an integrated category and supplier relationship strategy like a business."

Following are four areas in which skills need to be markedly advanced in VFS efforts:

1. <u>Technical expertise in the category</u>. For several types of categories — especially those of a highly technical nature — having an in-house technical expert to provide deep technical understanding is mandatory. This person need not be a part of supply management. At F&B, technical expertise was resident within procurement for a key category covered by the case study. At HiTech, R&D took the lead in managing the development of the new component by suppliers while the procurement organization managed the component's supply once it had matured into a commodity item.

- 2. <u>Research and analytical skills.</u> VFS research skills include thoroughly understanding supply market structure and dynamics (including several tiers back), evaluating in-depth supplier capabilities and finances, estimating value chain costs based on cost drivers, and gauging present and future demand, both for the company and the market in total. Analytical skills include financial and cost analysis, modeling, use of optimization tools, and identifying and evaluating risks.
- 3. <u>"Soft-side" skills.</u> Because cross-functional and cross-company actions are often at the core of VFS strategies, soft-side skills are critical to successful implementation. These include change management skills like those needed to foster collaboration (e.g., two-way communications, persuasion, cultural sensitivity, empathy and conflict resolution), to innovate and create, and to lead diverse teams. Cultural sensitivity includes dealing with different societies around the world

as well as other companies that may have different management styles. Although not strictly a softside skill, foreign language skills are often a plus when working globally. Healthifoods underscored the need to develop the right skill sets and language skills in its procurement organization to support the company's globalization strategy. Related to this was the need for strong change management skills to overcome biases, for example internal "phobia" related to using suppliers from developing countries.

4. Program and project management skills. Several companies interviewed referred to the need for strong project and program management skills to keep resources focused and on schedule when implementing VFS strategies. This skill set marries the soft-side ones mentioned earlier with skills such as project planning, delegation, problem solving, and budget and schedule management.

Future Considerations

In a few instances, companies pointed toward an emerging problem they had experienced retaining people with the skills needed for VFS. In one case, the company had a managerial career path that rotated individuals through various departments as they moved up in the organization. While this practice helped its top talent build knowledge of multiple functions and develop a wider network of contacts, it worked against the retention of individual performers such as those with deep supply market industry expertise. In another, retaining people with experience in developing markets became a challenge as other companies lured them away with greater rewards or opportunities. These two cases point out the need for companies to rethink how they keep skilled resources onboard to support VFS strategies.

Finally, if VFS is going to become an important part of the overall mission of supply management, the adoption of a new mindset throughout the organization will be required. This will begin with all members of the purchasing organization, from CPO to beginning buyer, increasing their awareness of the source and use of strategic value for each existing or future key spend category.

A Perspective on Enablers

The examples of and observations about enablers described in this chapter are quite consistent with other studies conducted by CAPS Research and A.T. Kearney. Each of the seven enablers is a building block on the path to excellence in supply management. Together, they form the foundation for developing and implementing VFS strategies.

The variety of company stories represented in this study demonstrates that VFS is a journey rather than a destination. Few companies had all of the right enablers fully in place at the outset of their VFS efforts. While some companies studied built their VFS successes on a long history of supply management excellence, others note that the root of their successes in VFS grew out of relatively recent work.

Metropolitan traces the origins of its success back to a transformation effort in procurement that began in 2005, when it adopted a center-led organization model. In addition to getting better visibility and control over spend, the new structure allowed best practice sharing, improved talent and greater flexibility to deploy resources against value opportunities. In 2009, when the company faced a severe margin squeeze, it formed eight strategic commodity management teams with coleadership by the business units and procurement, and joint accountability for objectives and results.

ComCo is still in the midst of procurement transformation, but already has seen early successes by using its structure of global commodity leaders (category executives) to develop and implement the commodity strategies across seven different supply chain units. Work still needs to be done to win back the trust of some of its suppliers, to strengthen crossfunctional teaming and to work in a more coordinated way across regions.

Examining the enablers demonstrates that successful implementation of VFS requires more than just transformation of supply management. A clear lesson for those companies aspiring to increase value from supply is the need for strategic, process and organizational alignment across the whole company to find and deliver more value from the supply side of the business.

Chapter 6: Conclusion

Supply management has been steadily transitioning over the course of decades. A function that initially focused on supply continuity advanced to take on competitive cost management and is now examining ways to add strategic value. As seen in this research, this transition is occurring more quickly in some companies than others, has a different emphasis — protecting or creating new value — for some categories, and is connected to stakeholder and senior management in different ways. In Chapter 3 (Examples of Value Focused Supply Strategies), Chapter 4 (A Framework for Implementing Value Focused Supply), and Chapter 5 (Enabling Value Focused Supply), we have outlined what must be done to develop and execute Value Focused Supply strategies.

Transitioning to VFS from Traditional Sourcing

The future competitive environment will require that companies carefully evaluate when and how to apply VFS. Figure 6-1 illustrates that VFS strategies will most likely be employed for those purchases that present major opportunities for value creation in supplier marketplaces that pose significant constraints, such as limited capacity, technology hurdles or significant capital requirements.

Nonetheless, traditional sourcing is and will continue to be important. Price/cost improvement will remain the dominant focus for traditional sourcing. It will tend to be applied to protect value in supply markets in which there are competitive alternatives and for which there are constraints around supplier selection and switching. Finally, there will be a transition of selected purchase categories from traditional sourcing to VFS as supplier marketplaces become more complex or as more potential to meet strategic needs emerge.

Where Do We Start with Value Focused Supply?

In this research, many of our examples show VFS applied as a result of "trigger points" — 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 of Figure 6-2.

For the future, leading companies will need to systematically develop supply strategies and their enablers to meet the strategic needs of today and for the future. 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 Figure 6-2. 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 meet the needs for individual VFS initiatives.

Longer term, an ongoing organization tasked to orchestrate the development and implementation of the company's portfolio of VFS strategies might be the supply executive committee. The committee, comparable to a marketing or finance executive committee, could 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 stakeholders viewing individual suppliers as their own responsibility, with supply management responsible for identifying qualified alternatives and competitive pricing, the supply base Figure 6-1

Value Focused Supply is different than traditional competitive sourcing; however, both are important based on the category



must instead be viewed as a corporate resource aimed at meeting the company's strategic needs much in the same way that marketing, financial or technology resources are identified and deployed.

To determine whether an individual organization has the capability and is ready to take on VFS, we have developed the VFS Readiness Assessment Tool in Appendix B, which measures whether the VFS enablers described in Chapter 5 are sufficiently in place.

A natural question given this ambitious objective would be: "Where should I start? Is this a push or a pull effort?" Undertaking this type of mission requires a sensitive balance between demonstrating the capabilities to fulfill it, and with promoting the request to create the role from a trusting senior management team. Making senior management aware of the value of such a mission without seeming self-serving becomes the challenge.

The Role Played by Senior Management in VFS

What do the companies in our research tell us about the involvement of senior management and senior

executives in other functional departments? As shown in Figure 6-3, 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 — 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 Duraman, F&B, Healthifoods, Metropolitan and Pharmacare, top management sponsored broad-ranging initiatives focused on capturing value that included supply management as a key contributor or element to the process. Multifunctional, multiunit teams were established to spearhead the approaches. In addition, specific supply categories were addressed by multifunctional teams 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 multidisciplinary teams to seek VFS opportunities. At Bentham, systemic

Figure 6-2

Future leaders will systematically link supply to business strategy

Current pioneers are already demonstrating value by addressing specific categories

2010

Future leaders will compete through Value Focused Supply contributions to company growth and profitability

2015 and beyond

- Developing strategies ad-hoc for important categories in reaction to problem focused trigger points
- affecting the category
 Using informal processes to create those strategies ("learn as you go")
- · Developing enablers as needed
- Providing project-based governance

 Developing creative ongoing engagement and governance of category strategies

- Supply Executive Committee (BU heads)
- Supply Stakeholder Committee (functional heads)
- Systematically developing and managing a portfolio of VFS category strategies
 - Today's categories that will remain strategically important tomorrow
 - New categories to support business and technology strategies
- Employing a formal process for strategy development focused on EVA and growth
- · Investing to create or strengthen enablers

barriers were overcome to open up a promising revenue-producing opportunity. Bigtru harnessed a team to create an alternative material that overcame barriers that would have made the company uncompetitive if left unchecked. Carco's top management supported the restructuring of a supply network that was not set up to do what was needed to support a new strategic direction sought by the company.

At other companies, functional support was obtained by supply management to protect or create Value Focused Supply. At Apollo, collaboration between packaging design, marketing and suppliers enabled the establishment of an industry standard for a new product package. A new executive at ComCo embraced a crossfunctional approach. At Globalgoods, finance and legal were the key contributors that worked with supply management to develop an innovative way to share in value capture with suppliers.

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 VFS. We did not see a well-established, systematic approach to VFS of the sort portrayed on the right side of Figure 6-2. What would be required to set up such a program? The steps to promoting a systematic approach to VFS are examined in the following paragraphs.

Promoting a Systematic Development of Value Focused Supply

Demonstrating the link between strategic value to the company and supply opportunities/options becomes the main hurdle to establishing an ongoing program for VFS. Some of the steps to initiate awareness and understanding of VFS might include the following:

- Publish a "Supply State of Play" document for senior executives annually. This document should report on the baseline strategy for each VFS category and report any shifts in their strategic role, competitive position, technology vectors, pricing or supplier marketplace.
- Hold a "value mapping" workshop with key executives once every six months to capture, confirm and update links between strategy and supply of key value elements. Create new versions

Company (disguised)	Industry group	Кеу	Top Management Role
Apollo	Media and entertainment	F	Connection varies depending on their previous experience or interest in supply management
Bentham	Engineering, procurement and construction	т	Division management supported - okays secondary steel approach
Bigtru Co.	Automotive supplier	Т	Top management organized and funded multidisciplined team
Carco, Inc.	Automotive OEM	S	Supply management, with top management support initiated strategic review of tooling costs throughout the value chain
ComCo, Inc.	Power systems	F	New executive embraces cross-functional supply approach for next-genera- tion products
Duraman, Co.	Consumer durables	т	Top management sponsored an engineering-procurement collaboration that dramatically reduced product complexity and cost
F&B, Inc.	Consumer packaged goods	т	Overall corporate program established functional cooperation – R&D , engineering and procurement drove one of many VFS categories
Globalgoods	Consumer packaged goods	F	Finance and legal worked with supply management to set up program
Healthifoods, Inc.	Consumer packaged goods	Т	Top management revised the planning process to include VFS -type approach
HiTech, Inc.	High tech	F	R&D led the design phase with procurement for the key new component
Meditrend	Healthcare delivery	F	Medical leadership participated with experimental program
Metropolitan, Inc.	Raw materials processing	Т	Top management initiated multidisciplined approach
Pharmacare	Pharmaceuticals	т	Part of an across-the-board program to address costs - addresses a strategic category
Powercon Co,	Industrial control systems	S	Supply management initiated lead time reduction and quality improvement at key supplier
Techco, Inc.	High tech	F	Collaboration with suppliers by engineering, supply chain, and operations.

Top management supported many of the VFS categories

Legend: Cat Key - T = Top Management Support, F = Functional Management Support, S = Supply Management Driven

of the value map due to new products, markets or other major shifts, such as technology leapfrogging.

- Hold a value mapping workshop with a key supplier(s) every six months, gradually inviting other executives to the workshop to engage them in a more comprehensive and complete value map.
- Prepare a strength/weaknesses/opportunities/ threats (SWOT) dashboard for VFS categories and update it on a quarterly or biennial basis. Engage representatives from a continually widening set of stakeholders as input for the SWOT dashboard.
- Prepare a "five-forces" analysis for VFS categories — provide continuous access to the executive team and update as needed.

As indicated earlier, building the linkage between company strategy and supply will initially be organized through a supply stakeholder committee. Activity will culminate in the establishment of a supply executive committee that will protect and create value through focused supply strategies. The supply executive committee will track and safeguard the VFS categories and create new value from the innovative use of new VFS strategies. Committee members will be drawn from the top levels of operating unit management; the committee will be led by operating executives and supported by all other functional executives, including supply management.

This transition will not be completed easily. Supply management executives must be able to create and share this vision with others in their organization, profession and value chain. As an example, we have created a "Supply Management Mission Statement for the Future." While that future may arrive as soon as 2015 for some advanced companies, it might be a safer bet for 2020 for many companies given the traditional resistance to supply participation in strategic issues. For laggards, it may not come before 2025.

Supply Management Mission Statement for the Future

What would a mission statement look like for a supply management organization in a company that has been able to establish a supply executive committee as a systematic organization to address VFS? We believe that such a mission statement would include the breadth of vision and understanding of the key value components and capabilities needed to be a key player in VFS endeavors.

Following is a mission statement that could be adopted ...

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"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, <u>mobilizing scale and innovation</u> to support our company's strategic objectives, instead of just relying on individual efforts to meet cost reduction targets
 - Mission Be the <u>go-to people</u> for knowledge of the source and use of strategic value for each existing or future spend category at our company
 - Mission Be the <u>leader</u>, influencer or participant in the creation of leading-edge, innovative valuefocused strategies for strategic purchases
 - Mission Be the <u>trusted provider</u> of knowledge as well as the implications of strategic risk for each existing or future spend category at our company
 - Mission Be the <u>accomplished team</u> 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 <u>collaborative and information</u> <u>connection</u> between our customers, other company functions and our suppliers to <u>map value creation</u> 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 VFS? 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?

Our research has shown that several of the elements for VFS are already there at many of the companies studied. In selected areas at a few leading companies, supply management executives have been able to identify truly strategic categories, build the enablers and obtain the resources needed to protect and create value from supply and through suppliers. Moving forward, it will be a challenge to spread the VFS strategy knowledge more broadly, understand the strategic needs more clearly, and promote stakeholder and executive participation more widely. But for many it will become the defining moment of their careers in supply management, and an outstanding contribution to the competitive success of their companies.

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 VFS have the opportunity to achieve breakthroughs in value creation as executivelevel resources are creatively applied across functions to VFS for strategic purchases.

Appendix A:

Apollo

Executive Summary

Packaging design for mass-merchandised products can pose many challenges because there is always a strong need to balance aesthetic considerations against cost. Developing the packaging for a brand new product with an eye toward making it the industry standard is even more challenging, especially when working on the endeavor with a supplier that has its own motivations.

Apollo, an international entertainment company, faced this challenge by partnering procurement with creative services to jointly work with a supplier to achieve design and cost goals. Additionally, Apollo created a package that helped unify the adoption of a consistent look and feel for a new entertainment product that promoted the acceptance of a new technology.

Background

With the launch of a new entertainment platform looming, Apollo was working in concert with the platform developer and several other entertainment and media companies to explore options for packaging its new products. Because this new technology platform would be competing against both a previous generation content delivery system and another new technology platform, there was a strong need to differentiate the new offerings through attractive packaging. At the same time, the development of a single, readily identifiable package design — an iconic package design — that could serve as the industry standard would be competitively advantageous to all. While Apollo had packaging design expertise in-house, its capability was geared more toward visual design than the creation of a mass-producible inexpensive package. For that, a supplier's expertise would be required. Apollo's procurement function would serve as a partner to the creative design team while also bringing a strong practical perspective to considerations like cost, manufacturing and distribution.

The goal was to design an appealing yet affordable package that combined aesthetic and practical considerations. This design would then be compared to competing offerings from other media and packaging companies to potentially determine a universal packaging design in advance of the consumer-focused launch of the new entertainment platform and supporting media.

Approach

While the end goal for the packaging development project was clear, the path to it was fraught with challenges. Questions around who would pay to develop the physical prototypes and which company would own the intellectual property — as well as how enforceable IP rights would be — were part of the challenge. Uncertainty around the timing of the release of the new media device and its supporting software, as well as the initial sales quantities that would be required, introduced additional complexity.

Apollo's creative department and a frequent supplier partner developed the first-pass concept for the package design. At this point, Apollo procurement department

joined in the effort to work on some of the more practical aspects of the design and how to source a finished product derived from it. Confident in the partnering supplier's ability to mass produce the package, Apollo entered into directed negotiations with it.

While both parties had skin in the game, the supplier had the more significant risk/reward considerations. Beyond the sheer resource time it had already put into the project, it would be required to invest in tooling and raw materials simply to put forward the design for industrywide consideration. The supplier shared its cost basis with the company, giving it significant transparency into the process that would prove useful for sourcing. While trust was the initial ingredient that made the partnership work during the concept phase, the supplier's prospects brightened significantly when the co-developed design was chosen "best in show" at a market research event attended by all of the major players that were developing and supporting the new entertainment platform.

The supplier then had to make some decisions around how it would meet market demand — it could attempt to be the sole supplier of the new package (and encourage knockoffs) or license the right to manufacture to other suppliers, which would provide an additional revenue stream beyond what it could make by manufacturing the product. Apollo favored the latter arrangement, as it would allow it to source from multiple suppliers to create price competition and ensure adequate supply.

The supplier ultimately opted to license the design to other manufacturers to provide additional capacity as well as produce the distinctive packaging itself. The existence of alternate suppliers meant that Apollo had the opportunity to keep its partner supplier competitive.

Results

From Apollo's perspective the project was a resounding success. Looked at solely in business terms, it achieved its goal by delivering the packaging at the desired price without incurring any material R&D costs. It also drove substantial top-line revenue after the technology platform launched through sales of the new media.

From an industry standard it was an even greater success, as the consistent size, shape and look of the packaging supported and even added to the perceived value of the new media format. Cost targets were met for all participants, as the design licensing created a competitive supplier market with the capacity to support product growth. Even retailers benefited because the standard packaging helped them to comerchandise the media and the platform.

Looking Ahead

While acknowledging that a similar project of this magnitude is unlikely to be embarked upon in the foreseeable future, Apollo learned some valuable lessons that will help it in future package design efforts. Intellectual property protection is one area for which it has a better sense, as suppliers quickly came to imitate the successful design in an attempt to circumvent licensing costs. Apollo also has an increased appreciation for the need to lay out a strategy upfront — not to stifle thought evolution, but to ensure an efficient development process.

Bentham

Executive Summary

For companies in the process industries, time truly is money. Any shutdown of a plant that is designed to operate around the clock means the facility operates in the red while idle. Conversely, anything that can be done to bring increased capacity or new capabilities online ahead of schedule increases revenues.

Bentham, a leading engineering, procurement and construction (EPC) company, developed a new source of highly specialized equipment that broke a monopolistic situation in its supply chain that had forced Bentham's process industry customers to accept very lengthy lead times to add new processing capacity. Doing so allowed Bentham to win billions of dollars in new business by positioning access to this new supply as the lead-in to selling projects that would be brought online more quickly than before.

Background

Oil refineries require a set of specialized equipment to conduct a pre-refining process for a necessary grade of raw material. Due to Bentham's broad client base and knowledge of the oil and gas industry, the company's leadership recognized that a significant number of refineries were approaching the end of useful life for this equipment.

Although replacement of the specialized equipment was necessary at regular intervals during the operational life of a facility, the low frequency of such replacements, when combined with the limited number of refineries worldwide, resulted in a stable supply base with long lead times for the equipment. Bentham's analysis showed that the regular replacement cycles for several refineries were about to coincide, creating a period of increased demand for which the only response available, based on the current supply market, would be increased lead times. When combined with additional demand expected from new builds and facility expansions, it became clear that creating a solution to overcome the equipment shortage would give Bentham a competitive advantage.

Approach

Bentham studied the supply chain to see what had to be overcome to reduce the long lead times necessary to service these potential customers; increasing the speed with which new units could be brought online would offer a significant value proposition. The procurement team found the bottleneck — the specialized equipment that had an extremely long lead time in the supply chain.

Unfortunately for Bentham and its potential clients, a single Asian supplier had a virtual monopoly on this highly specialized capital equipment — it had the post-welding processing capability and access to needed metals supply. The barriers to entry for potential alternate suppliers seemed insurmountable.

Yet this seeming crisis afforded substantial opportunity if it could be overcome, and Bentham set out to do so. Although North America was a frequent target market for this sort of facility expansion project, capabilities needed for this type of specialized equipment no longer existed.

Bentham then looked overseas, where it found several European mills and fabricators that appeared promising. After an extensive technical review, it was concluded that both the materials and craftsmanship in those European companies were as good as those of the incumbent Asian supplier. By providing a new source in place of the Asian supplier, Bentham estimated that it could cut the three-year lead times for delivery in half and bring new refineries online half a year ahead of its competitors. After developing a sound business case, procurement gained executive buy-in and the go-ahead decision was made. In fact, procurement supported a trial sales call at the first potential customer to demonstrate the strength of its new value proposition.

Bentham then developed and implemented its new European supply chain, playing a nontraditional role by buying steel plate from mills and supplying it to the fabricators, negotiating deals that allowed it to lock up the plate supply in Europe to successfully block others from copying its strategy. Sewing up the supply also provided an additional revenue stream, as it sold the plate to the fabricators.

Results

While Bentham had traditionally pursued business like any other EPC company, it opted to offer the new source of equipment to win new business, with the requirement that buyers then employ the company for the EPC services associated with the equipment installation. Selling activities for this new solution were centralized around an executive team in order to better define the offering. Procurement regularly met with this selling team to monitor production needs.

Over an 18-month period, the company won all seven pursuits that used this new sales strategy — all concluded without going through the full request for proposal (RFP) process.

A three-pronged approach was used to prove the viability of the new supply source to skeptical customers. A detailed information package was made available that explained how the supply chain would work and how the suppliers had been qualified. A second source of verification was provided by an internal expert with a reputation as an industry expert who could explain the process to potential customers. Those customers who wanted to view the fabricators first-hand were taken on site visits.

Because the sales strategy proved to be so successful, some "scrambling" was required in order to get the supply chain operational. But the implementation proceeded smoothly, and the expectations around delivery time and quality were met.

The strategy ultimately proved to be unsustainable due to external market forces. As demand for the refineries' finished products dropped, so too did their need to add the new capacity that Bentham and its competitors were offering. Nonetheless, the impressive winning streak the company embarked upon generated substantial revenues and profits, as well as showing that a sharp procurement organization that understood its supply market was a good resource for new business ideas.

Looking Ahead

Having demonstrated its ability to succeed through nontraditional strategies and to grow the top line, Bentham's procurement group continues to explore new opportunities while maintaining relations with the European suppliers in the event the market forces shift again to increase the desirability of refinery expansion. In addition, other business units at Bentham seek to engage the procurement organization in situations where supply market knowledge might help improve their competitive position.

Bigtru Co.

Executive Summary

Companies regularly develop new products as well as variants of existing products. Much less common is the practice of developing with suppliers brand new "ingredients" for use in an existing product that is designed to perform as well as, if not better than, the raw material that is being replaced.

One company that manufactures auto and truck components and systems did just that in order to bypass the cost and supply challenges of a fairly common metal that was a part of a steel alloy it used extensively. The company worked with a supplier to develop a new alloy and achieved significant cost savings. However, it also ran into some obstacles, pointing out the importance of knowing as much as possible about a supplier's capabilities, as well as its financial situation, when forming a partnership.

Background

Bigtru Co., a diversified global manufacturer of automotive components and systems, was looking to improve cost structure and position itself for an emerging market opportunity for its end products by working closely with the supply base. With material purchases representing approximately half of its cost structure, the company needed to find new ways to increase the value of this spend.

This need was made more urgent by rapid price increases for the stainless steel that it uses to make a key class of engine parts that represents more than \$500 million in business annually. The market for this part has grown in tandem with the increased demand for motor vehicles in emerging markets and a changing market in its traditional customer base, which requires smaller parts as well as parts that can operate under more demanding conditions.

Two different grades of steel are commonly used to make this engine part. While a lower end alloy is used where possible, there is an increasing demand for parts made from a "super alloy" stainless steel. Stainless steel parts using the super alloy have traditionally been used in diesel engines and in applications related to the exhaust system, as both present extremely corrosive situations. Engines powered by newer fuels such as ethanol also require this extra protection against corrosion.

Bigtru Co. wanted to reduce its dependence on the stainless steel formulation it was using, which would require it to find a substitute. Price volatility was a key driver behind this decision, along with domestic scarcity and high tariffs on imports. After exploring potential substitutes in the marketplace, the company decided the best course would be to develop a new alloy that would meet or exceed the higher grade stainless steel's strength and ability to resist wear and corrosion. The company expected to reduce its need for a certain ferromagnetic element used in the super alloy by 30 percent to 50 percent if this project succeeded.

Approach

The company began the new alloy development process by considering which of its current strategic suppliers could best serve as a partner for co-development. Over the course of half a year, a cross-functional sourcing council that included engineering and procurement as well as operational leads screened a number of suppliers as part of the company's six-level phase gate process for new product development.

The supplier chosen to partner on the project was one with which the company had a close working relationship and strategic alignment. It also had strong technical and engineering capabilities. To help ensure that the new alloy would stay cost competitive once it was brought to market, the agreement stipulated that Bigtru could move its business to a new supplier if its cost goals could not be met.

A joint company-supplier team worked at the supplier's facilities for two years to develop the new alloy, with many formulations tested before the team arrived at the final product. The supplier had significant skin in the game, as it had invested capital into the process with no guarantee of success. Joint patents were awarded for the new alloy, which the company believes put it three years ahead of its chief competitor.

Additional work had to be performed before parts made from the new alloy could be brought to market. Prior to selling parts, Bigtru Co. had to obtain buy-in from the OEMs that it sells to — a challenging process since

many of them single-source this particular part for given platforms. The supplier had to modify its manufacturing processes in order to accommodate the new formulation. After a two-and-a-half-year development process, Bigtru achieved full production using the new alloy for the high-end version of the key automotive part — half the time traditionally required to introduce a new alloy.

Results

In the early running, the company and supplier appear to have enjoyed a sizable success with the joint development endeavor. Quantitatively, the company has already reduced its use of the ferromagnetic element by about 57 percent for targeted applications, resulting in millions of dollars in savings. Qualitatively, success was demonstrated when Bigtru won a significant innovation award for the project from one of the automotive industry trade publications.

The company cited its strong relationship with the supplier coming into the project as a significant factor in its success. The integrated team working together onsite and the willingness to commit to a multiyear investment were also key components.

The ongoing restructuring of the U.S. steel industry poses some challenges, as manufacturers of the steel used in this automotive part are exiting the business. At the same time, demand for the part made from the new alloy is increasing in several foreign markets, which has resulted in the company seeking out potential local suppliers in those markets to produce the alloy under license from the supplier.

Most challenging is the fact that the economic downturn of 2007-2009 drove the supplier into Chapter 11 bankruptcy proceedings. This will likely require Bigtru to find and work with a new supplier, which will need to make changes to its manufacturing processes in order to produce the alloy.

Looking ahead

As the company searches for new suppliers of the alloy, it will leverage lessons learned in the joint development process. The candidates' financial health will be paramount in the selection process; z-scores alone will not suffice in predicting whether the supplier is likely to go bankrupt. Financial data, even from privately held companies, will be carefully scrutinized. As with the selection of the initial supplier, site visits will also be important, as the potential supplier's process capabilities will be emphasized in the candidate evaluation process.

The company's new understanding of processes such as melt technology will help it to target suppliers with the right capabilities. Capacity and productivity will be important in order to produce the new alloy quickly.

A similar joint development process will be put to use as the company begins to develop a variant of another current piece of engine technology.



Carco, Inc.

Executive Summary

Companies that undertake supplier development efforts tend to do so with the intent of being the chief beneficiary of this resource investment. But in some cases, helping a supplier become more competitive can bring significant and sustainable benefits for all of the companies involved.

One global automotive company that transitioned from offering a handful of models to a fuller portfolio of vehicles found that its costs per vehicle were increasing as models became more segmented with lower volumes for unique parts and tooling. It identified tooling as one addressable spend area that had rapidly increased in its North American operations, where it had come to represent nearly one-sixth of the cost for some models.

Committed to its strategy of sourcing locally, Carco, Inc. began working with its tier-one suppliers and the toolmakers that supplied them in order to find ways to improve the cost basis and other key considerations around tooling. The ultimate goal to help the tooling companies become globally competitive suppliers to the company's value chain.

Background

The North American division of this global automotive company had shifted its product mix over time from several high-production models to a broader product line with more models and more frequent product freshenings. With fewer of each model being sold, its tooling costs were rapidly rising in terms of the cost per vehicle built. Additionally, Carco's benchmarking indicated that tooling costs in North America were higher than in other parts of the world. Where tooling had represented around 2 percent of the cost to produce a high-volume model, some current models were running as high as 15 percent.

While the automaker was committed to its preferred practice of sourcing locally, it had a clear need to reduce its North American tooling costs. Doing so would require it to reach beyond its tier-one suppliers to work with those suppliers that performed tooling for component parts manufacturers. While tooling was viewed by some as a commodity business, the company saw this skill as a value-added facet of its business and wanted to develop a supply base of toolmakers with specialized, retained knowledge that would be able to build upon previous learnings.

The company's overall strategy for tooling called for improvements to its quality, cost and delivery competitiveness, along with the establishment of a globally competitive tool sourcing strategy that balanced costs and risks. The strategy also included an initiative to jointly engage in R&D with its North American suppliers and the toolmakers that supplied them.

Approach

The company's strategy centered around the development of long-term relationships with tooling shops and tier-one suppliers that would create value for all three players by reducing costs for the company and the tier one suppliers, and providing a consistent base of business for the toolmakers. The latter area required some deliberate calibrating, as the company did not want to provide more than one-third of any given toolmaker's business in order to encourage them to work with other companies and not become solely dependent on any single customer.

The company and its tier-one suppliers stood to gain local tool sources that were competitive in terms of quality, cost and delivery while managing risk and maintaining localized know-how. The tool shops would benefit by becoming globally competitive, receiving the benefit of the automaker and suppliers' knowledge, and gaining a consistent level of business that would encourage them to make the proper investments by removing some of the uncertainty that typically plagued these small businesses. Most of the tool shops had annual revenues of less than \$20 million.

Carco, Inc. examined the many factors that drove the cost of tooling and concluded that simulation, standards and design were the most readily addressable aspects, as they were at the front end of the process and would ultimately have the biggest impact on assembly time and cost. To address them, the company set up improvement streams around technology and business process innovation. The former encompassed concepts such as the use of standardized tool design software, tool design that could accommodate variations of tools for different automobile models (a practice the automaker refers to as the "same but different" approach), forming simulations, shop floor

programming, faster cutting speed and tools, and improved knowledge of ultra-high-strength steel. Business process innovation encompassed process efficiency, lean manufacturing, benchmarking and design-manufacturing integration.

By using the "same but different" approach, tool shops developed and maintained engineering know-how and improved their quality, cost and delivery abilities. In one striking example, the time needed to develop a tool for a "same but different" part was cut in half compared to the initial tool for the base part. This allows the automaker to wait until later in the development process to release designs to tooling, reducing design changes' cost impact on tooling. Rework costs due to design changes also were significantly lowered.

While the automaker did not grant direct financial support to the toolmakers, such as for software purchases, it did provide opportunities for them to work with business partners to help with the transformation process, which was designed to make the tooling companies more competitive for all of their customers. Training was provided on overall equipment effectiveness and other aspects of the tool shop business to improve the tool shops' business models and management, and push them to develop a culture of continuous improvement.

Improving the Process for Injection-Molded Parts

In one area, injection-molded parts, the strategy led to investigating ultimately a shift away from steel tooling could be made. Steel tooling results in long-lasting tools for high-volume models — but at a higher cost than aluminum alloy tooling. The automaker saw clear benefits to aluminum tooling. Toolmakers would be able to perform faster machining and have shorter lead times. Molders would have shorter processing times and reduced part distortion due to aluminum's superior heat dissipation. The automaker saw an opportunity to meet its quality goals while reducing its investment in tooling. However, the durability of the aluminum tooling in a high-volume production condition was the most significant unknown.

The company began with a pilot in which it worked with a pair of its plastic injection-molding suppliers to evaluate build efficiencies and process cycle-time improvement. Assuming most of the expense itself, Carco closely monitored tool maintenance to hedge against durability concerns, employed a third-party tester to validate the quality of the alloy and undertook a study of the alloy's texture capabilities and repair methods. Having concluded that the aluminum tooling was sufficient for low-volume models, the company then examined its durability and projected, and whether confirmed, that it would also hold up to high-volume work.

Results

By working collaboratively with materials suppliers, tierone suppliers and toolmakers, the automotive company unlocked substantial value from the tooling category. While it incurred some expenses in select work streams, it executed the project using existing resources from the supply management group.

The initiative to adopt aluminum molds for injectionmolded parts brought major benefits. For one lowvolume part, tool manufacturing lead times dropped from 17 weeks to 13 weeks. For other low-volume parts, tooling costs were reduced anywhere from 6 percent to 12 percent, and processing cycle times between 15 percent and 30 percent. For one particular high-volume part, the lead time was reduced from 23 weeks to 20 weeks, processing cycle time was cut by 21 percent and tool cost savings of 8 percent were achieved. Overall, the shift from steel to aluminum alloy tools brought savings through machining efficiency, reduced cycle time and improved throughput due to improved thermal conductivity, a reduction in the number of molds and injection machines needed, and reduced machine tonnage due to the lower injection and clamp pressure needed when working with the aluminum tool.

Just as importantly, the automaker helped the tooling companies transform themselves from a commodity business to a value-added contributor, which will bring stability as well as the potential for continuous improvement and innovation-related contributions over time.

Looking Ahead

The automaker continues to look for ways to extract increased value from the tooling category, and is encouraging its tier-one suppliers to craft a strategy for it that will include other potential alternate materials and sourcing locations.

ComCo, Inc.

Executive Summary

The move from traditional cost-focused methods of category management to a value-focused approach can bring many challenges for both the buyer and suppliers. Developing trust is just the first step in a long process toward transparency. Companies that are able to work with their strategic suppliers as if they are an extension of the company can realize powerful results.

ComCo, Inc., a global manufacturer of power systems, has started working toward this desired end state, developing new techniques of value-focused category management that it plans to apply to the products it designs and manufactures. By using cross-functional teams and carefully evaluating suppliers to find best fits, the company is learning new lessons almost daily as it undertakes the journey.

Background

The technology-driven global manufacturer of power systems has begun a multiyear effort to redefine supply management. Globally, it is shifting its make-versus-buy mix to 70 percent buy and 30 percent make. As part of this endeavor, it is examining ways to standardize design for components that are manufactured both internally and externally.

This new supply management philosophy led to the reorganization of the company's procurement structure. The organization introduced a new category executive role that works across all of its supply chain units (SCUs), which each have responsibility for one of the main product sections.

These SCUs were tasked with bringing new approaches to supply management, with a goal of developing integrated value-focused strategies by the end of 2009. The new quest for value beyond sourcing and contracting is consistent with the needs of a company that develops products with long lead times.

The company has begun to apply value-focused category management to all categories. One of these subcategories that has a heavy engineering orientation is made both internally and externally while the other three less-engineered part types are primarily purchased from the outside. Cross-functional teams that include representatives from the procurement, manufacturing, manufacturing engineering, quality and development functions have begun work on this category. While the global commodity leader owns the strategy, all team members will be evaluated based on progress implementing the strategies. Finance will track the key metrics, including cost, quality and delivery.

Approach

The move away from its traditional category approach to value-focused category management has required the company to make a significant philosophical stepchange. New attention is being paid to implementation and ongoing relationship management. Suppliers are being asked to add value — low prices and on-time deliveries are no longer the only important components of the relationship. The drive is on to achieve cost transparency in the supply base, which requires close relationships and trust. Taken to its logical end, valuefocused category management could do away with price negotiations entirely through early supplier engagement and cost transparency.

While suppliers are not involved in the development of commodity strategies, they have been engaged regarding how business will be done under the new strategy. Cross-functional workshops have been used to share select elements of the strategy with suppliers in order to begin talks on work streams that will help align them with the strategy. These detailed discussions establish performance indicators and performance improvement needs as well as outline the path by which suppliers can become strategic suppliers to the business.

Some suppliers were hesitant to share information on costs for reasons ranging from confidentiality concerns to backlash against the company for past treatment. Only those that share this information are being considered for participation in the new product development program.

As it gathered information, ComCo, Inc. held regular meetings with its global purchasing executives and global category executives to review suppliers' fit with the company's total-cost-of-acquisition program. These discussions proved fruitful. For instance, it was discovered that one global supplier that was selling to the company at a relatively low volume could add value for current and future parts through a combination of design change and volume cost reductions.

Numerous virtual and face-to-face value improvement workshops were held with suppliers over the course of several months to review both the technical (design and cost) and commercial (flexibility, quality, deliver and financial health) aspects of the supplier. Potential component costs were reviewed, yielding results such as the possibility of a redesign that could eliminate an entire section of a part in order to save material and labor costs.

In order to promote manufacturing best practices, the company established a best practice sharing forum that gathers multiple suppliers — including competitors in some cases. The manufacturing research centers are also a means to improve manufacturing processes along the value chain.

Results

With the effort ongoing, the key results to date center on the lessons the company has learned in working on its initial value-focused category management strategy. The effort undertaken thus far confirms that a cultural shift will be required within the company in order for this new way of working to take hold. While crossfunctional teaming will be important, the company is also improving its ability to work across geographies in order to drive consistent approaches and achieve consistent results. Communications are proving crucial, not just to suppliers but within and across teams and geographies.

Looking Ahead

While work continues, the new integrated valuefocused commodity strategies — including tasks, responsibilities and timing — were submitted for approval in Q4 2009. Expectations are that speed-tomarket and OEM requirements will be achieved or exceeded for total cost/value to customers.



Duraman, Co.

Executive Summary

While companies are finding success with many procurement strategies, driving deep results and adding value through these efforts typically requires the involvement of multiple stakeholders within the organization. It is rarely enough to simply assemble cross-functional teams on an initiative-specific basis. Achieving results and driving continuous improvement requires the active involvement of a range of parties, often on a global basis.

Duraman, Co., a global diversified consumer durable goods manufacturer, was struggling to control input costs. In an effort to fix that problem, it created an organization design that incorporated complementary functional resources to manage the complexity of its products and to source according to new specifications. It also decided to go deeper into its supply base when sourcing raw materials themselves, instead of concentrating on the components that it had more commonly sourced. Doing so allowed Duraman to achieve new depths of savings without sacrificing quality or the very features that customers valued.

Background

Duraman faced significant competition, requiring it to place a new emphasis on cost leadership. While the company had traditionally focused on component costs in its sourcing efforts, executive leadership realized that it would have to deepen its efforts by unlocking new value from the raw material purchases used across many internal manufacturing processes and purchased components.

A new emphasis on complexity management was called for in order to rationalize specifications and enable aggregation of spend across the corporation. This work would require a new consideration around what product aspects the customer actually saw and valued. An engineering-driven component complexity management (CCM) team was assembled to focus on reducing design complexity across product lines and geographies, included rationalizing and simplifying the range of components and materials bought from the outside. This new, global way of working was expected to achieve a far wider and deeper reach than the company's previous attempts at complexity management, which had been done project-by-project based on geography.

To help drive the raw materials sourcing effort, the company formed a value-focused raw material (VFRM) team. The goal of the new team was to provide a bridge between the CCM efforts and the supply markets by unearthing supplier/material alternatives that could help reduce product design complexity and to develop sourcing strategies based on and in support of the complexity reduction strategies.

To succeed in its raw material sourcing efforts, the company's CCM and VFRM teams would have to combine their efforts on a centralized, ongoing basis to improve the manner in which the company purchased the many raw materials required to manufacture its products.

Approach

The company determined that it required additional resources to identify and evaluate value-creating opportunities, which was initially done on a pilot basis. One early success was the determination that some steel parts were being made with a finer finish than was necessary and could be substituted with a lower cost finish. It was found that the steel parts were important to product functionality but not visible to the customer. Based on such findings, the company decided to look for other specification change opportunities that could be extended across entire product lines.

The CCM team's focus included improving collaboration between purchasing and product engineering, accelerating component consolidation, driving the development and implementation of global design guidelines, assuring adherence to rules to reduce raw material complexity, enhancing sourcing strategies that built on complexity reduction, identifying opportunities for material or component substitution, and enhancing product reuse and visibility.

Key activities for the VFRM team included identifying and selecting the best materials, sourcing globally, driving continuous cost and quality improvement, integrating raw material technology roadmaps with suppliers, leading the identification of new material technologies from the supply base and selecting key global suppliers with which to partner. The joint team

of engineering and procurement resources was also given accountability for governance of raw material specifications globally. All team members shared the same objectives for standardization, cost reduction, project implementation and governance.

The teams worked their way through more than a dozen different raw materials during the project. The CCM team looked across all plants and products globally to determine what grades and types of a specific raw material was being used, what it was being used for and to develop an overview of the supply base. The VFRM team then developed the sourcing strategy for each raw material.

The project teams also leveraged the supply base, including collaboration between suppliers, to create new value. On one major product conversion effort, the company assembled a multicompany team that included a key raw material provider, an adhesives supplier and an equipment manufacturer in order to develop an optimum solution for making its product. This upfront effort and evaluation of risks and trade-offs was expected to drive millions of dollars in annual savings.

The teams also developed governance rules that focused on aspects such as what specific conditions could trigger the creation of new part numbers, how specifications were to be tracked and guidelines around "preferred" materials. These rules were intended to guide product design and raw material choices to provide long-term competitive value.

A scorecard was developed to measure the annualized cost reduction and cash flow for projects. This joint measurement also enabled those projects that did not appear fruitful to be abandoned and resources redeployed to other materials. The total value contribution of specifications and suppliers was also measured, including functionality, conversion cost and material price variance.

Results

The cross-functional, multiteam approach that this consumer durable goods manufacturer employed in its raw material category improvement efforts drove significant results in a number of areas. Cost savings by specific commodity ranged between 5 percent and 20 percent, while the complexity reduction and global purchasing approach allowed it to reduce inventories by more than 15 percent, freeing up additional capital. Standardization of materials will continue to drive benefits to indirect and administrative costs as fewer materials and SKUs need to be managed at multiple locations and by engineering, procurement and materials groups. The value of direct cost savings delivered in the first 12 months was more than 10 times the investment made in resources.

More importantly, the company believes that it has improved the quality of its products even as it reduced the costs to produce them, allowing it to better match competitors' pricing without sacrificing those characteristics and features that its customers value.

Looking Ahead

The company intends to continue its efforts around raw material sourcing, including increased raw material coverage and further implementation of complexity reduction through governance rules early in the product design and development process. By focusing efforts early, improved functionality, cost reduction and increased value across the supply chain to the ultimate customer can be achieved. In the process, it will continue to eliminate functional silos while increasing global coverage across all product lines and strengthening global sourcing strategies.



F&B, Inc.

Executive Summary

While every company undertakes cost reduction efforts at some point, what is done with the savings varies. A careful balance should be struck between rewarding shareholders and investing back into the business.

Is it possible to "have your cake and eat it too?" F&B, Inc., a worldwide consumer packaged goods company, is attempting to do so by investing savings from its companywide global cost reduction program in increased marketing spend geared at growing the top line. The company's goal is to save more, advertise more, sell more and profit more.

Having had success around efforts that targeted aspects like packaging and ingredient variation, the company turned its focus to lowering the cost of the commodities used to make its products. By simplifying product specifications, looking for ways to use less of a key ingredient and employing breakthrough technologies and new supplier partnerships, F&B has begun to achieve significant savings in commodity areas that had once appeared to be at the whim and mercy of the markets.

Background

F&B undertook an ambitious program to reduce costs through improved purchasing methods and to reinvest the savings into marketing in order to grow the top line. As with many major consumer-focused brands, the company considers marketing to be its core competency; any additional resources it can apply to promotions in order to increase sales are highly coveted.

Each of the company's divisions has a three-year savings goal that is being met through actions like strategic sourcing, improved warehousing/logistics and complexity reduction. A year into the program, the company began to examine ways to optimize its ingredients spend. One key category of ingredients used by three divisions that represented as much as \$300 million in annual spend was chosen as a pilot area. It was chosen because of its size as well as the steady increases in the price of the specific commodities within this category. While the potential rewards were great, so also were the risks. While earlier work in this cost-reduction project removed complexity from packaging, ingredient changes could potentially change the very tastes that consumers had grown to value. Though the category under consideration would appear to be functional and relatively low in complexity, it had actually become highly fragmented due to the wide range of specifications that had crept into various product formulations over the years. It was imperative that the company learn to unlock what the customer valued before altering any formulations.

Undaunted, an experienced cross-functional category team set to work on a three-phase plan to simplify product specifications, use less, and employ breakthrough technologies to reduce cost and customer deliver value in this key category of ingredients.

Approach

The initial work was internally focused, as the company's R&D function devised ways to change product specifications and use less of this key ingredient type — in some cases in an attempt to make products healthier, and in others to reduce the variants that the company would have to buy.

While the overall category represented around \$300 million in spend, just more than one-tenth of this amount is actually addressable at the supplier level. That is because the vast majority of the costs come from the raw animal, vegetable and chemical ingredients sold on exchanges that serve as input to this category. The real opportunities were in reducing the suppliers' supply chain costs.

Key to engaging suppliers was building their understanding that this was not the traditional type of zero-sum sourcing model in which any savings the company achieved would come at the expense of the supplier. If the company could increase sales it would have to increase its buys, so while margins might be lowered, the suppliers would receive increased volume as the company sold more product.

The company focused on eight specific suppliers from which it purchased the three main types of product in this category. One-day conferences were held with each

of the suppliers in order to help develop their understanding of the program and F&B's strategic goals. The new ingredient specifications were also outlined for the suppliers to help give them a sense of what types of changes they would need to make. Cost modeling was performed for each formulation to help determine what the cost structure would have to look like to achieve the company's target prices and which supplier had the best cost structure by product.

A segmenting exercise was then held so that the company could determine which one specific supplier could meet its needs in each of the three product types — at which point the term "partner" was introduced, as the company would essentially be sole sourcing for each of the three. The three selected suppliers were eager to take on the additional business from the company, and in some cases this allowed them to exit less desirable businesses in order to concentrate on their new partnerships. R&D supported collaborative company/supplier efforts to improve manufacturing efficiencies and reduce costs.

These partnerships have allowed for a shift from quarterly to biannual contracts that guarantee the company a price in exchange for guaranteed volumes. Price formulas are cost based, which has stabilized cost components on the manufacturing side. The suppliers also leave some capacity open in the event that F&B's business increases.

Also critical to creating value was understanding what the customer valued and then optimizing the value chain from ingredients through manufacturing efficiency and capital utilization. For one product, the company determined specific product attributes most valued by consumers, allowing the company to reduce costs in attributes that the consumer did not care about while improving attributes the customer valued most.

The company has also begun to process or manufacture some of the ingredients in-house in order to reduce handling and packaging costs and waste. This also gives the company first-hand knowledge of processing technologies and costs that help it better understand the supply market.

Results

In most direct terms, the company has achieved more than 12 percent in savings from addressable supplier manufacturing costs. But the results of this project have actually extended beyond the company and its partners. Resource allocation and supply chain optimization caused a shift in the entire industry around this key ingredient category, creating new efficiencies for the industry and the companies that depend on it.

Looking Ahead

While the company has enjoyed significant results to date, its goal is an additional cost reduction of 10 percent from this ingredient category over the next five years. One way it expects to cut costs further is by unlocking innovation from its new partners. As the supplier relationships have been enhanced with targeted business, suppliers are willing to enter into longer term technology projects.

Globalgoods

Executive Summary

For fledgling suppliers, adding a large, strong consumer packaged goods (CPG) company with a well-known brand provides a kind of reputational lift to the customer base. Why shouldn't the highly regarded CPG buyer benefit from the use of its reputation by the new supplier?

Globalgoods, a leading consumer packaged goods company, has experimented with capturing additional value from suppliers that benefit from its reputational lift. Globalgoods has entered into several arrangements in which it agrees to increase its buys from selected suppliers with the understanding that doing so should increase the supplier's asset value as a business.

Background

Globalgoods was determined to find new ways to generate value from its supplier relationships. Strategic sourcing, supply base consolidation and supplier collaboration were just a few of the techniques that the company had successfully implemented in recent years to improve both its top and bottom lines.

Despite the value that Globalgoods derived from superior pricing and service from its suppliers, it was perplexed when it saw additional value accruing to supplier owners or investors from the reputational lift it provided — additional value that seemed to result directly from having Globalgoods as a prime customer. After considering a number of avenues, the decision was made to pursue new deals with suppliers that would ultimately result in the suppliers making direct payments back to Globalgoods through several different types of arrangements in exchange for increased value.

Approach

First, Globalgoods had to determine which suppliers in which spend categories had the potential to benefit from obtaining it as a lead customer. Then it had to determine if a financial arrangement could be created where any increase in market capitalization could be monetized for return to Globalgoods. Working through its existing global strategy for key purchases — in which categories are "owned" by a procurement leader who negotiates deals in tandem with strategic relationship managers — the company set about analyzing potential opportunities, which were led by procurement with the close cooperation of legal and finance.

This analysis included a number of factors. Supply market fragmentation and supplier ownership structure were deemed particularly important. To identify candidates for these new types of deals, an analysis was conducted of a supplier's capabilities, ownership and economics, as well as the supply industry structure and the manner in which the supplier creates shareholder value. Globalgoods targets fragmented supply markets in which there are specific suppliers that it wants to do more business with that might be open to sharing market capitalization increases in exchange for additional volume.

Globalgoods had to determine what supplier ownership types would simplify the capture of value created by the relationship. Private equity and potential IPO of closely held companies were particularly attractive. Suppliers that are owned by private equity firms that could be looking to take the supplier public may be especially interested, as may publicly traded suppliers that are looking to spin off a part of the business as a separate company. If a supplier touts Globalgoods as one of its key customers, it sends a clear signal to the initial public offering (IPO) markets that the supplier has a stable business base.

Globalgoods market value capture program began two years ago, but is still in its early stages, with arrangements in place with two suppliers and negotiations under way with two others. The first two involve "equity value rebates" on purchases, while the deals currently being negotiated would involve the company receiving income by exercising warrants based on the supplier's achievement of market capitalization increases.

Equity Value Rebates

For the two agreements that are in place between Globalgoods and a supplier, the equity value rebates that Globalgoods receives are based on a combination of the supplier's market capitalization and the volume of business it does with the company. The financial models used to develop the rebate formulas are based on publicly available financial data.

The range of rebates differs depending on whether the incremental volume represents organic growth (~10 percent rebate) or an acquisition or capital investment (~20 percent). For example, if the volume of business being conducted allows the supplier to penetrate a new geographic market, then Globalgoods receives a larger share of the benefits. Globalgoods will make volume commitments in cases where the supplier must make a capital investment. Rebates are paid based on annual performance and booked in terms of the cost of goods sold (COGS).

Warrant-Based Agreements

For the two more recent deals currently being pursued, Globalgoods and privately owned suppliers are trying to monetize benefits that would be achieved by exercising warrants when the supplier is sold or spun off. In the event that no IPO occurs, then the owners of the supplier would issue shares to Globalgoods, which would then sell them to recoup the value.

One of the deals that Globalgoods is discussing also involves joint development of a new molecule that the supplier would then manufacture using its own assets. This will likely require an additional variation in the value capture agreement.

Results

Because this is a pioneering strategy, the main results for Globalgoods have been financial based on the first two agreements where suppliers pay equity value agreements.

There have been a number of lessons learned that Globalgoods intends to leverage in future pursuits. It has learned that it needs the right combination of supply market, supplier and people in order to succeed on a deal. Finance and legal must work closely with procurement on these deals from the start - with the full support of these functions as well as the executive suite. Finance will be challenged to keep track of the volumes and financials and to verify that the supplier does not allow value to "leak." Finance must drive through to ensure continuing market capitalization. Legal may have concerns that an arm's-length relationship is maintained with the supplier in order to steer clear of challenges from potentially injured parties, such as insider-trading accusations or appearances of impropriety.

To build support for this program within the procurement function, the concept of increasing volume purchased from a single supplier must be consistent with the overall category strategy. Cost, quality, innovation and other key criteria remain the most important factors for the category; the added value from an agreement should enhance rather than be the sole source of value in the relationship.

Looking Ahead

Globalgoods continues to examine its supply base for supply markets and potential partners for this new sort of business arrangement. Categories with accelerated growth plans are potential sources for additional application — where increased spend is anticipated, a good candidate might be found. Additionally, potential suppliers will be easier to deal with if they have a concentrated ownership structure to simplify buy-in. Nonetheless, the market value capture program has attractive expansion benefits for Globalgoods as well as other companies with a reputation from which suppliers might benefit.

Healthifoods, Inc.

Executive Summary

Healthifoods, Inc., a global food and beverage manufacturer, faced strategic challenges for its products and its markets. Previously, Healthifoods' product strength was its ability to create mega brands in the developed world using developed world materials and production techniques, and then export those products to developing world markets. Traditionally, Healthifoods' markets were predominantly in the developed economies with the developing world playing an incremental role. More recently, Healthifoods has focused on responding to emerging growth markets in developing economies with a more diverse set of products meeting local taste and customs.

Healthifoods' procurement organization played a key role in extending this strategy by shifting from its traditional European capital equipment suppliers to local market suppliers to support its entry and expansion efforts in the markets where it anticipated growth. The procurement organization then used these new supply relationships to source for its manufacturing locations worldwide.

In doing so, the company was able to increase its probability for success in the new market penetration and global sourcing efforts, using suppliers' knowledge of the local markets for ingredients and customer preferences while driving substantial cost reduction for equipment in all of its markets.

Background

Healthifoods forecasted significant growth in some developing economies and comparatively flat sales in its existing (better developed) markets. While it had historically earned the vast majority of its profits in North America, over the next several years Healthifoods projects a more even split in sales and profits between North America and the rest of the world.

Rather than depending or concentrating on capital equipment supply markets from Europe and North America, serving customers in new growth markets would require plants filled with an array of capital equipment that the company would source in or near the local market. If it could succeed in finding quality supply to support its market penetration strategy, the company could leverage suppliers in these growth countries to support global sourcing. In these new growth markets, Healthifoods' product mix was becoming more fragmented, either with newly introduced products appealing to local customs and tastes, or with once-dominant brands introducing a steady flow of variants to meet customer demands for variety. With an annual spend exceeding \$1 billion, capital equipment represented a significant spend area for this company — success in shifting capital expenditures to lower cost growth markets could bring substantial benefits in terms of costs, and with support for product and growth strategies.

Approach

As the company began to explore sourcing opportunities in growth-oriented markets, it became clear just how much supplier consolidation had taken place over the previous half decade in the capital equipment industry. The number of suppliers worldwide capable of manufacturing the types of production equipment that the company used had dropped by more than 75 percent. Suppliers in the lower cost growth target countries were fairly evenly split between local and multinational corporations.

In one key developing market, the company had sufficient demand to undertake sourcing as well as supplier development. While many suppliers in mature markets were already moving manufacturing to low-cost countries, Healthifoods' leverage was sufficient to hasten these moves.

As local suppliers developed as a feasible alternative, the company was able to obtain lower prices from traditional equipment suppliers. By conducting competitive sourcing efforts, the company was also able to use low-cost country sources to meet some of its need for capital equipment in mature markets that were undergoing a product demand shift that required new production capabilities.

To ease its market entry efforts, the company worked with local suppliers to obtain added value around its new customer base as well as the local supply market. Consumer preferences for product formulation (e.g., degrees of sweetness, texture, etc.) and the characteristics of locally sourced raw materials, in terms of processing and how best to use them in formulating end products, were some of the key inputs obtained through suppliers' experience serving other companies.

In tandem with global sourcing, the company also undertook collaborative efforts with suppliers to improve the capital equipment category. In several instances it acted as an integrator to bring suppliers together to improve a manufacturing process. It also developed contractual agreements with strategic suppliers to get a first look at their breakthroughs, which helped it to create new concepts for products.

Results

The local supply bases developed to meet the company's needs, allowing it to purchase equipment at a price in line with the local markets' economies. Using growth market sourcing for capital equipment, Healthifoods has already built 30 percent of its needs in Asia and Latin America. In China, Healthifoods can source 90 percent of its equipment needs, up from 30 percent. Similarly, in India the company has localized 50 percent of its needs despite increased challenges in transportation infrastructure and regulation. In addition, the company achieved significant cost reductions for capital equipment baselined against previous suppliers. Equally important, Healthifoods has agreements with strategic suppliers that grant it a first look at new ideas, and has linked its plans between production and marketingrelated equipment. The quality of its globally sourced equipment was very high, in some cases setting new quality standards.

Significant flexibility was also added to the company's sourcing network. Cycle time necessary to bring up a manufacturing line for a new product was cut in half in many instances. With suppliers in or near the markets in which the company produces and sells products, it can shift sources to take advantage of currency fluctuations.

Finally, Healthifoods procurement demonstrated that it plays a significant role in implementing the company's product and market strategy through this innovative approach to capital equipment sourcing.

Looking Ahead

Healthifoods' global sourcing experience has instilled a deep understanding that such work needs to be managed as an ongoing program rather than a series of events. Procurement was the only function that could look across all of the company's global needs for capital equipment to fully leverage overall spend. Global capital expenditures sourcing fed into the development of a global centers of excellence structure to manage all supply chain aspects, including sourcing, for key supply categories. Although Healthifoods offers different brands with different product characteristics in different markets, it is coordinating them globally. Healthifoods' procurement will continue to play an important role in the company's strategy for product and market development worldwide.

HiTech, Inc.

Executive Summary

To the layman who opens a piece of high-tech equipment and takes a peek inside, the circuit boards, silicon, metal and wires can seem as complex as an automobile. But unlike a car or truck, most computer equipment is assembled from a mere handful of components — a fact that makes each part absolutely crucial. Yet most companies go to market under the assumption that the whole of the product is greater than the sum of the parts contained within and look to compete on price, ease of use and other nontechnical aspects or features.

Those that do look for competitive differentiation through specific components can achieve startling results, as one global high-tech manufacturer did when it found a way to generate value within a single category. Based on an understanding of what its different customer segments valued, HiTech, Inc., developed a strategy to address each of them. It succeeded by getting to market well ahead of the competition with a technologically advanced design that offered a better total-cost-of-ownership proposition for its enterprise customers. This allowed it to increase both its own and a key supplier's market share while obtaining a premium price. Well-defined cost-reduction targets and standardized design allowed HiTech to serve other customer segments.

Background

HiTech, a global high-tech manufacturer that employs a hybrid centralized/decentralized procurement model, made the decision to centralize buying for those commodity categories that it purchases for use across multiple business units.

One key high-tech component that goes into many of the company's products represents more than \$3 billion in annual spend for more than 60 million units. This category is used in three distinct product lines in two of its business units, one aimed at both consumers and business and another that mainly sells to businesses.

As it does for other key commodities, the company employs a supplier scorecard that looks at five key factors around the supplier's ability to deliver within a category: technology, quality, supply, cost and additional business factors such as processes and sustainability. For this particular component family, each end-product line has different needs for technology, quality (reliability) and cost. Overall, weightings for each category may be different based on customer needs, which help define value from the customer view. Cost is very critical for the consumer-destined products, while technology and quality are key for enterprise end products. While there are six main suppliers for the category globally, not all are able to compete in each segment.

Because of the varying requirements the high-tech manufacturer has within this component category, it employs a multidimensional strategy for managing it.

Approach

HiTech has recently enjoyed success using two different approaches within this area of spend. For its line of products aimed at both consumers and business users, it has employed a somewhat traditional sourcing approach. But where it saw an opportunity to achieve genuine differentiation that could lead to competitive advantage, it jointly developed a new component for a major end-product line.

Traditional sourcing

For the two end-product lines that are aimed at both consumers and business users, the component under discussion is treated as a commodity item. The company has little involvement in the design of the components. Instead, it expects suppliers to develop and own the technology roadmap for their products in this category. In these instances, procurement takes on the lead role in working with suppliers while R&D plays a supporting role. Monitoring technology advances in these components is a key task for the company's procurement organization, as new developments can affect the design of its own end products; for example, the size of the component restricts the size and weight of the end product.

Within these two end-product lines, there are different component requirements (two basic size formats) and manufacturing strategies for the lines. Suppliers must manage two separate types of supply chains — one that serves a single manufacturing hub in Asia for one endproduct line, and another that serves multiple manufacturing sites globally for the other line.

For those products with geographically dispersed manufacturing sites, suppliers have to invest in local facilities to provide inventory and delivery. As a result, when manufacturing sites are brought online the company single-sources for each region to allow the supplier to invest and make a return until the volume



becomes sizable enough to bring another supplier online.

The company also makes quarterly share splits among suppliers based on performance against "cost of quality" metrics. The metrics are calculated based on costs of factory and field failure attributable to the component.

Developing a new component for major endproduct line in the enterprise product line family

For its enterprise business line, the high-tech manufacturer made the strategic decision to use a new design for part of its product line. The new design required a different type of data interface and physical format for the component in this category.

The company teamed with a key supplier to design and develop a new version of the component. This new design, which used an advanced data interface and was physically smaller and more suited to the end product, would offer a total-cost-of-ownership advantage through reduced energy needs and storage space, among other considerations. The R&D function took the lead role in working with the component supplier — instead of procurement leading the effort, as it does with many relationships — in large part due to the technical issues involved.

HiTech chose to collaborate on the design with this particular supplier because it had first-hand familiarity with its technological leadership — including its ability to work with the new data interface and its strong technical and engineering capabilities — and because of the excellent working relationship between the companies. Other suppliers were considered, but the company determined that the one it chose offered the best technical, cultural and strategic fit. In addition, the other suppliers were behind in technology development for the component.

The two companies' development teams worked closely together to design the component and determine how it would work with the new end-product design. Because the development costs were borne by the supplier in anticipation of significant market share growth, the supplier was especially eager to get to market in a timely manner. Development time was ultimately about 50 percent longer than planned due to delays related to another key component of the end product, but the successful launch of the end product yielded a full year of lead time advantage in the marketplace versus competitors.

Despite the close relationship that the two companies enjoyed, the supplier has not earned as much market share in the other two lines of business, presumably because the potential return on investment is not as attractive as what it achieved with the enterprise component.

While shifting to the new component technology for this new end product, the company considered rationalizing the supplier base of older technology components for this product line family. It could have dropped one of the suppliers completely, but because this supplier was a technology leader and a key source of components for another product line, the company opted to keep it active. While it resulted in a lost cost savings opportunity in the short term, the company determined that it was more important to keep the supplier viable in the longer term to avoid changing the dynamics of the supply base and achieving longer term benefits due to competition.

Results

The early introduction of the new technology-based component for a major end-product line in the enterprise product line family helped the high-tech manufacturer boost its market share in this product segment from 30 percent to 50 percent. Similarly, the supplier increased its market share in enterprise equipment to more than 60 percent.

During the initial roll-out, the supplier acted as the sole source for the key component at a mutually agreeable price. Now that the technology is maturing, the company is considering migrating business to one of the other three manufacturers that could supply the component. This move is being considered in order to achieve cost advantages now that the advantage around technology has eroded.

Looking Ahead

Longer term, the company expects to migrate its two product lines that are aimed at both consumers and businesses to components that operate at higher speeds. Currently, one product line's component operates at a much higher speed than the other. Standardizing the higher speed will reduce the supplier's manufacturing costs, simplify the company's component SKUs and allow it to use smaller format components in one of the product lines. Several challenges remain, however. While there are technology constraints to overcome, the larger obstacle comes from suppliers that are reluctant to support such a move due to fears that their margins will be pressured should this shift happen, as they currently receive a premium for the higher speed component.

Meditrend

Executive Summary

Meditrend, a major integrated healthcare delivery provider, has been seeking a way to engage its supplier community, medical staff and patients in a processwide improvement in the cost-effectiveness of medical care. It has focused on using its unique, systemwide perspective to analyze particular services from results back through patients, medical procedures, supplied materials and equipment.

As part of that quest, Meditrend arranged to partner with a university class to analyze the interaction between medicine and economics for hip and knee replacements and revisions. The university team hoped to establish an analytical tool that could be used by physicians and administrators to evaluate the differences between procedures, physicians, patients and suppliers.

The team created an analytical model for the intraoperative period, which extends from the time the patient is wheeled into the operating room for surgery until the time the patient is transferred to the postanesthesia care unit. The model's implementation will be used to demonstrate variations for that subset of the total joint replacement process pathway to various participants.

Background

Like most companies in the healthcare field, Meditrend, a major integrated healthcare delivery provider with millions of members and more than 10,000 physicians, has been working to combat rising costs. While Meditrend has successfully executed cost-control measures through strategic sourcing and specification efforts in recent years, its analyses have traditionally focused on a total cost of ownership that did not account fully for how products and consumables were actually used in the operating room.

Drawing inspiration from Toyota Motors' production system, Meditrend is taking a holistic look at medical processes and procedures in order to identify and ultimately drive out waste. With the goal of providing quality, affordable healthcare, the long-term goal is to analyze both practices and outcomes in order to develop standard protocols that will bring about the best outcome for the patient undergoing specific procedures. Included in these protocols, which are focused first and foremost on patient outcomes, will be the specific equipment and products to be used in performing the procedure. This will allow for the achievement of cost savings through consolidated spend on specific, standardized items that deliver the clinical results desired. In addition to spending more with fewer suppliers, there may also be an opportunity to move to performance-based supplier contracting based on how a supplier's products affect the outcome and cost equation.

A significant area of interest for Meditrend is the evaluation of product performance in light of the time it takes to perform a given procedure, as well as the success in terms experienced by the patient. Many manufacturers claim unique advantages both in terms of time to perform as well as success realized from a given procedure. The study is allowing doctors to evaluate products, equipment and protocols in terms of cost to procure, the length of time and associated costs to perform a procedure, and then relate those factors to patient outcome.

While Meditrend knows that doctors have preferences — some are based on experience with specific pieces of equipment that they normally employ, others due to the reputation of products from competing medical equipment and drug companies — the study is aimed at reconciling evidence-based medicine with evidence-based procurement and establishing a new value equation based on comparative effectiveness.

Approach

A team that includes representatives from the medical staff, the patient quality care and delivery excellence unit, and procurement worked with a university class to develop a model to analyze the effectiveness of the approaches taken by medical staff for orthopedic procedures. This specific procedure has been selected because it is thought that the model developed can then be applied or adapted to a range of different surgeries.

The project team worked with anonymous patient data. Eighteen different factors spanning cycle times, costs, adherence to standard procedures and certain aspects of patient outcomes were analyzed. The model produced comparative data with respect to the products and devices employed in the procedure, compared the surgical protocols that were followed, contrasted the


quality procedures employed, analyzed the human capital engaged in the procedure and determined how to minimize turnover time.

While the cost of purchased products are a key consideration for the company, it recognizes and accepts that the costs of purchased products could conceivably increase should the more costly items reduce the total cost of ownership around the procedure through superior outcomes.

Results

The university team reported on the results of its analysis of the intra-operative segment of the overall process at one of Meditrend's major facilities. It created a model that was scalable (more surgeons and processes can be added), extendable (its structure can be modified and extended to other procedures) and dynamic (input costs can be changed or tested). The cost model provides physicians with detailed visibility into the cost of their procedures and allows benchmarking and best practices sharing. The model allows Meditrend to view cost breakdown by doctor or procedure, has drill-down capability to view inventory cost, labor cost and material cost, and can facilitate side-by-side comparison and variation analysis. Applying the university team's approach to the rest of the facilities in the Meditrend network would conceivably save \$210 million annually, without considering applications to other medical procedures.

Looking Ahead

Meditrend will continue to create holistic models for process cost-effectiveness. It plans on continuing to raise the awareness of results-oriented analysis within the medical community to drive change and reduce costs. It also will use the results of this and continuing work to direct supplier behavior.

Metropolitan, Inc.

Executive Summary

Volatility in raw material costs can place significant pressure on a company's business, especially when selling prices are largely fixed by an independent commodity exchange.

Metropolitan, Inc., a global manufacturing company, has been able to successfully navigate this difficult environment and differentiate itself from its competition in several direct material categories by designing and deploying detailed commodity strategies to address the unique challenges the business faced within each commodity. The strategy work done within one particular commodity category (input x) was especially noteworthy because this category has significant influence on profitability. Left unchecked, pricing volatility within this commodity could squeeze margins to an unsustainable level.

Background

As a world leader in the production of intermediate, primary and finished products, Metropolitan traditionally allowed its business units significant purchasing autonomy. In 2005, however, it adopted a new center-led procurement model that greatly increased the company's global perspective and leverage. As a direct result of the maturation of the center-led procurement model, the company was able to form and deploy eight dedicated cross-functional teams at the beginning of 2009 specifically designed to sustainably reduce spend across the corporation. The CEO and the Executive Council directly sponsored this effort, and it made procurement leaders and business leaders jointly accountable for delivering on aggressive spend reduction targets.

The market for input x is dominated by two types of suppliers — integrated suppliers that produce and refine the primary feedstock to produce and market the end product and merchant suppliers that purchase and process the primary feedstock to manufacture the end product. In the last five years, the merchant market has rapidly consolidated and now only two dominant global players remain in this segment. The number of integrated producers of input x has also been reduced over this same time period as several feedstock sources have been permanently closed or partially curtailed for economic reasons. Deteriorating feedstock quality has

also tightened this supply market over time, and this structural change has shifted more power to producers.

Supply/demand for input x was globally tight. Multiyear contracts were traditionally negotiated across the industry and pricing was typically set on a semester basis and was often tied to a published commodity index. Due to a lack of liquidity and inherent market transparency, the index would lag and inaccurately reflect actual changes in the market. Moreover, producers had disproportionate influence over the index reporting process and, as such, the timing and magnitude of price trends could be easily manipulated.

Individual Metropolitan plants had considerable autonomy to set specification limits for input x, resulting in a proliferation of unique specifications across the manufacturing portfolio. Input x had significant leverage on total cost of goods produced and plants were very sensitive to quality parameters, although the cost of quality was not well understood. Plant managers were largely focused on process control. Specification changes were considered a sacred cow.

Metropolitan set out to improve the situation by shifting power away from the supply base, improving portfolio flexibility and increasing market transparency.

Approach

The company's input x cost improvement strategy focused on the following key initiatives:

- Rationalizing specifications for input x across the portfolio and changing the paradigm for how and where specification decisions are evaluated and made
- Designing and deploying a standard total cost model for the enterprise to uniformly evaluate the total cost impact of changing multiple specification parameters
- Designing and deploying a system optimization model to optimize specification change costs, freight and storage costs, and material pricing across the enterprise
- Upgrading market intelligence gathering and analysis capabilities on a global basis

- Exploiting the company's global footprint, supply chain expertise and market intelligence capability to efficiently leverage regional arbitrage opportunities around the world
- Eliminating the use of index pricing and focusing on informed bilateral negotiations with individual suppliers
- Communicating openly and proactively with independent market surveyors to drive Metropolitan's agenda in the marketplace and balance the influence that input x producers had typically wielded over the publication of price indexes
- Backwardly integrating into strategic parts of the input x supply chain to reduce market risk and improve market transparency

The successful implementation of this strategic plan was largely enabled through the direct sponsorship of the CEO and executive team, strong cross-functional ownership/collaboration between procurement and business leadership, and the deep involvement of the plant operations and corporate technology teams. By achieving greater insight into the total cost of supply on an enterprise basis, including the cost of quality, and using this analysis to modify its business risk profile, Metropolitan has uniquely positioned itself versus the competition to minimize the absolute cost of input x as well as the volatility.

Results

The implementation of the company's input x cost improvement strategy was timely. It helped the business to weather the impact of rising raw material costs and rapidly falling sales prices at the outset of the global financial crisis as well as driving continuous improvement in cash management metrics throughout 2009. Metropolitan also credits the cross-functional nature of the improvement effort and direct sponsorship by executive management as an integral part of its ongoing success in this area. Where the business was once primarily concerned with the quality of inputs in order to avoid process upsets at the plants, now plant management and other supporting functions have gained an increased sensitivity and awareness to the total cost of supply. The flexibility achieved across the company's network of manufacturing facilities has pressured suppliers to be more competitive around both price and quality, as suppliers now know that they can and will be swapped out.

This strengthened market position has given Metropolitan a new platform from which to develop balanced, long-term relationships with select suppliers.

Looking Ahead

A consistent strategic framework is being employed across other direct material categories with similar results. The new cross-functionally collaborative culture at Metropolitan continues to deepen and evolve across the enterprise, making significant spend reduction paradigm shifts more achievable and sustainable.

Pharmacare

Executive Summary

While there are many common sourcing practices for addressing areas of direct spend, it is believed that indirect service spend offers relatively little potential for sourcing opportunities. Too many companies have demonstrated limited interest for sourcing areas like human resources, marketing and especially legal services.

For companies with sizable indirect spend, new approaches are a must. Pharmacare, which relies heavily on law firms to define and protect its intellectual property and defend against lawsuits, identified several new approaches that have collectively yielded substantial cost reduction. Pharmacare achieved notable results by:

- Direct sourcing ancillary legal services that had previously been billed through law firms
- Adopting performance-based fee arrangements
- Negotiating alternative billing methods that pay firms by the task rather than the hour

Background

Legal services represents a major spend category for pharmaceutical companies due to the need to protect intellectual property worldwide and the potential exposure to lawsuits. Pharmacare has hundreds of people in its in-house legal department and obtains additional services from more than 300 external law firms around the world. The large number of firms is driven primarily by the need to use country-based firms to file and maintain patents and trademarks around the globe, and the need to have national coordinating counsel and regional representation at the local jurisdiction level because of mass tort litigation in the United States. Legal spend is substantial (several hundred million dollars annually) and is clearly a strategic category due to its centrality as well as the potential risk to the business if legal services are not handled correctly.

At Pharmacare, the legal department traditionally purchased legal services. The company viewed legal services as a highly technical and complex area with the potential to expose the company to significant risk and thus best managed by those that practice law. Yet decisions the legal department was making about which firms to use were typically made on an informal or ad hoc basis, frequently based on personal relationships rather than a thoughtful selection methodology.

Several years previously, Pharmacare had undertaken an internal audit that unearthed some sub-standard practices around the purchasing of legal services. Without having procurement involved in the process, there had been no systematic approach to sourcing with minimal coverage by sourcing plans. Savings were not being measured and there was limited compliance with preferred supplier lists. Supplier diversity targets were unmet, and verbal commitments were often used instead of clear engagement letters.

Because of its recent successes in other indirect category management, Pharmacare's General Counsel agreed to a two-step assessment of the legal department's spend by procurement. First, an internal assessment was conducted by procurement, which uncovered sourcing practices previously used by the legal department. The assessment also examined how those practices and techniques compared to other sourcing practices used throughout Pharmacare. It included interviews with 25 Pharmacare attorneys from several groups across several geographies and ended with a findings and recommendations presentation to the Pharmacare legal management team. Then a benchmarking effort with 30 other companies, including competitors, was conducted to understand the strategies and practices that other companies were using. The benchmarking study concluded that the company was lagging behind its competitors, especially around cost transparency and offshoring of legal services. Procurement began to work on improving the value being received by Pharmacare's legal services in the United States and the United Kingdom.

Approach

Across Pharmacare, a corporate mandate was issued to all of the central functions, including the legal department, to significantly reduce operating costs over a three-year period and deliver true cost savings to the company. This focus encompassed both internal operating headcount and expenses along with thirdparty supplier spending A well-planned program was launched that included several work streams that applied direct sourcing of ancillary legal services, the adoption of performance-based fee arrangements and a movement away from the hourly billing system.

Historically, external law firms purchase ancillary legal services such as research, medical records collection, court reporting and disposition services, and discovery documentation and review on behalf of their clients from specialty companies at an additional markup. Pharmacare realized that it could use its pooled spending to make those ancillary legal service purchases itself and obtain superior rates.

A more challenging area was the implementation of performance-based fee arrangements with external law firms. The company worked with firms to develop an estimate of their annual fees based on the anticipated workload, then came to an agreement that the firms would receive an amount equal to that fee if their actual billings came within a certain amount above or below the fixed amount. If billings fell outside of this range, then the savings or overrun would be shared by the two parties. These partnering law firms could also receive bonuses if a suit was settled quickly or a potential mass tort case avoided.

Perhaps most notably, the company was recently able to move away from paying law firms according to the traditional billable hour plan in favor of an alternative billing arrangement that pays a flat, prenegotiated fee for specific legal services. The impetus for this action stemmed from an e-billing system championed by the American Bar Association that established standard codes for legal activities and allowed a firm's clients to track hours and costs associated with various services to a high degree of granularity.

Armed with this newly deepened insight, the company began to develop units of measure for legal work beyond simple hours. For example, it shifted the price it would pay for a witness deposition from hours to a cost-per-deposition model based on the historical costs it had paid for this service. The company has implemented this type of flat pay-for-service billing arrangement for approximately half of its total legal spend, including its 15 top law firms, and is also sourcing under this approach through its RFP process.

Results

Each year of this effort, Pharmacare has achieved increased savings while maintaining high-quality legal services. While the first three years yielded cost savings in the area of \$7 million annually, the implementation of alternative billing arrangements is projected to save an additional \$50 million for the other legal engagements for which alternative billing has been put in place. Savings are being measured and agreed to by both the legal department and purchasing to ensure that the company continues to receive high value legal services at lower costs.

Looking Ahead

Moving forward, Pharmacare expects to deepen its legal services spend efforts. While it is currently employing alternative billing arrangements for about half of its legal spend, it hopes to grow that to cover 80 percent, accommodating different business practices employed elsewhere in the world. Intellectual property services appear to be impenetrable at this time, although some trademark work is already being performed under alternative billing.

The sourcing of ancillary legal services is expected to continue for several years. Pharmacare also may reduce the number of firms it uses as national coordinating counsel in order to increase leverage. Litigation discovery work is currently moving from a billable hour model to a per-page measure, although in the longer run Pharmacare expects that technology will be able to reduce the number of documents that people must review.

Powercon Co.

Executive Summary

Long lead times tend to be expected and even accepted when sourcing globally. But there are instances in which suppliers demonstrate a chronic inability to provide satisfactory delivery performance. In such cases, the purchasing company typically has options ranging from constant complaining to termination of the relationship in favor of a new supplier.

Powercon Co., a global manufacturer of power, control and information solutions for manufacturing, was suffering from poor supplier delivery performance, but it opted to work with the supplier to determine the root causes of the problem. While it found that some of the issues stemmed from subpar processes, the company also learned that the supplier was largely unaware that a problem existed. By building an understanding of the expectation gap and suggesting ways to overcome the myriad pain points, the company was able to correct the problems, and improve its own economics and ability to serve customers.

Background

Powercon used a certain class of circuit board assembly across six of its manufacturing locations. While it had an in-house board production capability, it relied on an Asia-based preferred supplier to supplement this limited internal manufacturing during periods of growth.

Because it spent approximately \$70 million annually on about 300 part numbers that it did not buy from any other source, the company considered this supplier to be a preferred supplier. But with the supplier only achieving 50 percent on-time delivery performance and averaging 40 days late on those orders that were not arriving on time, the company did not in turn feel like a preferred customer.

The company undertook an examination of alternate suppliers but ultimately opted against the switch. A major factor for continuing the relationship was Powercon's diverse mix of circuit boards and its relatively low volume, which made it something of an unappealing account for large manufacturers. The company also realized that the switching costs quantitatively and qualitatively — would also be higher than it wanted to pay. The late orders brought about a host of problems for the company, which did not want to delay its own shipments and face customer service level issues due to a supplier's problem. The late orders were also limiting the company's ability to optimize its manufacturing operations, forcing it to keep excess inventory on hand to act as a buffer against these late shipments and costing it additional time and resources to follow up on shipment status.

The situation was clear — the company had to communicate the severity of this problem to the supplier and work with it to improve delivery performance or face the painful prospect of switching suppliers.

Approach

Although the company had made the supplier aware of its delivery performance problems when completing the supplier's customer satisfaction surveys, the supplier took no proactive action to remedy the situation. Similarly, direct complaints to middle management were not bringing about improvement.

In early 2007, the company undertook a formal effort to explore improvement options by assembling a crossfunctional team that included an expert in lean, Six Sigma, and quality and manufacturing functions. The goal was to receive improved on-time delivery performance in order to increase the company's flexibility and reduce inventory and lead times in its own deliveries to customers.

The company dispatched a lean, Six Sigma expert to spend three weeks at the supplier's plant in Asia in March 2007 to identify potential improvements. The expert examined setup, changeover, equipment, planning parameters, minimum order quantities, inventory and transit. Key findings included the fact 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, including 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.

In order to increase the supplier's buy-in to the expert's recommendations, the company communicated its dissatisfaction to all levels of the supplier, including senior management. The company clarified its expectations around improvement and established new methods for reporting progress, including monthly metric charts and weekly calls with the supplier's general manager.

In the course of its work, Powercon realized that there was a disconnect around performance between its own expectations and the supplier's. The supplier was accustomed to working for companies that ordered in higher volumes and in a more predictable fashion, and found itself challenged to meet the comparatively broad mix of lower volume items that the company needed. The supplier was also using metrics for on-time delivery that measured performance against forecasts rather than the company's actual orders. The result was the supplier's own on-time delivery numbers were much better than the company's measure of the supplier's performance. While the company does not believe that there was any deliberate intent to mislead, it suspects that the supplier's employees were being rewarded based on performance against their own self-developed measures rather than the satisfaction levels that were reported by customers.

Results

A year and a half after the company embarked upon the supplier improvement program, it achieved its goals. Deliveries have proven to be on-time 98 percent of the time, allowing the company to reduce its own customer lead time and on-hand inventory.

The company has also learned how to achieve results with other suppliers. With the company's encouragement, a supplier of a different type of circuit board improved its on-time delivery rate from 85 percent to nearly 95 percent in the course of a year allowing the company to reduce its lead times and inventory for this second type of board.

Both the company and its suppliers benefit from this improved way of operating. The company improves its own customer loyalty due to the improved order reliability. It also maintains flexibility in its own manufacturing, allowing it to better respond to order changes. Eliminating safety stock reduces the amount it has to invest in inventory, freeing up capital that can be employed in a variety of ways, including better pricing for its own customers. Suppliers also achieve value from going through this process. Powercon may opt to shift additional volume to these preferred suppliers. As preferred suppliers, they may also be able to share in the benefits of joint cost reduction through changes to the product line. Those that embrace the opportunities presented by a fuller Six Sigma effort can also achieve additional benefits.

Looking Ahead

The company continues to drive toward additional improvements with the circuit board manufacturer under discussion, including expectations of an annual 5 percent improvement in productivity and price.

While initial efforts focused on suppliers of several types of circuit boards, the company is working with suppliers in other sourcing categories as well. While each will have to consider whether the cost of the additional inventory it will have to maintain is worth keeping the company as a customer, there are also a host of benefits to be attained by receiving preferred supplier status.

Techco, Inc.

Executive Summary

While merger-and-acquisition activity can quickly grow a company, it can also lead to a highly fragmented supply base as acquired companies' suppliers join the corporate mix. Under such conditions, it will almost certainly prove difficult to achieve value from suppliers.

One leading high-tech company with a history of growth through acquisitions came to this realization and undertook a cross-functional approach to reduce the supply base for key categories. In one crucial area of spend, reducing the majority of suppliers made it possible to develop strategic relationships with the remaining supply base. This reduction made new collaborative efforts possible, enabling the company to achieve a host of quantitative and qualitative valuefocused benefits.

Background

Techco, Inc., a leading high-tech company that has steadily grown through acquisitions, found that it had also acquired many suppliers, creating a highly fragmented supply base. The company determined that it needed to revamp its sourcing and supply approach to improve performance, as approximately 60 percent of its product costs were supply chain related. Improvements in supplier capabilities, innovation, performance and competitiveness would be critical to its future success.

Management knew that it had a number of supply base areas to improve in order to evolve from its current state to the desired future state. It needed to improve supplier quality, delivery performance and predictability. It required increased innovation from the supply base, coupled with shared investments. It needed suppliers to become more cost competitive, both in terms of pricing and total cost of ownership.

An executive steering team was established to develop a category strategy optimization (CSO) approach. The team began by identifying those categories that were most critical to the success of the business.

For one crucial category of components used in a number of the company's products, custom electronic assemblies (CEAs), the company had 45 different suppliers for a \$100 million spend. Rationalizing the supply base would allow it to pool its spend and develop the type of strategic relationships that could add the value it was seeking. To increase supplier value contributions, a multistep, multidisciplinary process was developed and implemented.

Approach

In addition to devising the CSO approach, the steering team worked with other procurement, supply chain and technology leaders as well as Six Sigma analysts to develop a collaborative process that would help to rationalize the supply base in order to increase the strategic value of each supplier.

The CSO process began with a decision model and tools that were used to rank suppliers, factoring in the needs of different regions and business units. Points of emphasis during this ranking included supplier capacity, and whether eliminating a certain supplier would place the company in a sole source or other uncompetitive supply situation. Once ranked, the steering team developed exit strategies for those suppliers that would be omitted from the portfolio moving forward. It then developed the commodity strategy and execution plan for working with the most capable suppliers, including long-term pricing agreements and consideration of opportunities in growth supply markets. Detailed supplier surveys, engineer-to-engineer interviews and on-site visits verified supplier capabilities. The CSO process ultimately narrowed the field of 45 CEA suppliers down to eight - six external and two internal - preferred suppliers.

The company then set to work with its suppliers on a number of improvement and collaborative efforts via collaboration agreements that aligned both parties' goals and created a framework for working together. Technology roadmaps, improvement plans and strategies for test equipment, supply continuity, inventory management and relationship management were among the aspects included in these agreements. A number of metrics were employed to measure compliance, with quality and delivery strong points of emphasis. Quarterly business reviews were established to help drive and reinforce the relationships.

Using Six Sigma, a common test architecture was established in order to make functional tests a

consistent part of the working relationship by locating company testing equipment at supplier sites. Suppliers began to contribute throughout the product design process, to the betterment of CEA testing, manufacturing and procurement, and to the project bidding process.

To maximize cost savings, the company and its suppliers pooled their spend for common parts and began to share common parts across components and products. Techco made its material requirements planning schedule available to its preferred suppliers, along with an electronic library of drawings and specifications.

Results

The cross-functional CEA category management improvement effort yielded a host of quantifiable and qualitative benefits for the company.

Granting suppliers access to the e-library helped to speed up the bidding process, as revisions were delivered instantaneously and errors were significantly reduced — resulting in a 33 percent reduction in cycle time. Time to test and test quality improved, with yields increased by some 20 percent. This improvement reduced the need to return and resend product, cutting down on transportation costs.

Overall cost improvements in the CEA category have approached 20 percent. An increase in on-time delivery rates and quality also helped the company get product to market more quickly.

Looking Ahead

Techno expects that its initial successes will help it bring suppliers into the product design process earlier in order to help it deliver more effective designs at a lower cost, enhancing its competitive position.

Suppliers have proven to be more responsive to the company's needs, both due to the increased volume of business they are receiving and the company's diligent efforts in choosing the most capable CEA suppliers as partners. This responsiveness in turn allows the company to provide better service to its own customers.

Looking to the future, the company is exploring the feasibility of employing the CSO process throughout the business.



Appendix B:

Readiness Assessment Tool

As emphasized throughout this report, Value Focused Supply is a fundamentally different approach toward managing a company's most critical purchase categories. Among other things, it requires different types of goals, behaviors, information and analyses, relationships, organizational approaches and talent/skills than conventional sourcing approaches. As the research has illustrated, even advanced companies are still developing their capabilities to fully leverage the power of VFS.

To help companies gauge how prepared they are to successfully develop and implement VFS strategies, we offer this readiness assessment tool. For each of the seven enablers discussed in Chapter 5, Figure B-1 provides short descriptions of the ideal conditions for VFS success based on the companies studied in this research, while Figure B-2 provides a summary scorecard.

Instead of assessing the company situation as a whole, we suggest that the tool be used to evaluate VFS readiness for specific key purchase categories. Individuals completing the assessment for a category should rate how well each description in Figure B-1 matches their view of the actual situation using a simple scale of 1 to 4, where 4 indicates strong agreement, 3 agreement, 2 disagreement, and 1 strong disagreement with the description.

In terms of gathering data, a few suggestions include:

- Gather responses from a broad cross-section of the category's stakeholders and other relevant VFS participants; for example, leadership in the business units, supply management, marketing, finance and other applicable functions.
- Provide an overview of the principles behind VFS to the survey participants. More than likely, VFS will be a new concept.

- Provide a profile of the proposed VFS category to the survey participants. The "Supply — State of Play" document and SWOT dashboard mentioned in Chapter 6, coupled with the topics listed in Figure 4-4 on page 33 suggest areas that might belong in the profile. This context may provide helpful background to help them respond.
- When analyzing responses across individuals, we recommend calculating the average points by dimension as well as the ranges of scores.
- Use the survey as a starting point to evaluate the company's readiness for VFS. Its primary value is as a discussion starter within an organization to identify and address existing or potential roadblocks based on those dimensions that receive low scores.
- Address differences of opinion. If one enabler has a wide range of scores, we recommend discussing those differences in perspective. In some instances, survey respondents may have different interpretations of the question. However, in other instances, true disagreement may exist and the discussions may point toward actions needed to shore up low-scoring areas.

Figure B-1

VFS readiness assessment

*Transfer Points Tally to Summary Scorecard

Assessment for category:

4 = Strongly Agree
3 = Agree
2 = Disagree
1 = Strongly Disagree

Enablers Description Score Top level executives demonstrate support for VFS strategies, e.g. Executive Leadership through funding, communication, and/or mandate Recognition of and com-There is agreement among the executives on which categories have mitment to create value the strategic importance and value creation potential for VFS through supply Cross-functional under-Each functional leader understands how additional value can be crestanding of value opportu-**Executive Engagement** ated in categories to be addressed nities in supply Business units are willing to lead the coalition of functions; e.g., BU, Business unit ownership for results Finance, Supply Management, Marketing, etc. These is an oversight structure to guide VFS efforts, resolve con-flicts and embed changes Governance process **Executive Engagement Points*** Developing value-based We have supply-related metrics that measure value beyond cost, e.g., customer value created metrics Establishing joint goals We have joint value creation/protection goals and joint accountacross business units and ability across business units and functions Value Chain Goal functions Alignment and Aligning goals along the We have joint value creation/protection goals and joint account-Measurement value chain ability with VFS suppliers Certifying performance and We have independent validation (outside supply management) of results VFS strategy performance and results Value Chain Goal Alignment and Measurement Points* We understand in-depth the drivers and market trends affecting the Gain deep insights into the supply market from which VFS categories are procured and the end market supply market in which the VFS categories are used Supply Market Understanding Understanding day-to-day We have up-to-date market information on VFS categories to idendynamics tify and capitalize on imbalances in supply & demand Supply Market Understanding Points* We have processes and incentives in place to cooperate on VFS ini-Internal collaboration tiatives across business units, functions, and geographies Collaboration Collaboration and process We share plans and roadmaps with key suppliers, and work with integration along the value Approaches them to streamline joint processes and establish joint accountability chain and rewards **Collaboration Approaches Points*** We have shared visions and similar values and styles with VFS Cultural match suppliers We are committed to building on existing supplier relationships for Valuing the incumbent VFS categories Supplier Relationship We willingly share information openly with VFS suppliers, and are committed to treat each other fairly Trust and openness Characteristics We engage with our VFS suppliers at multiple levels, e.g., our engi-Multiple touchpoints neers to the supplier's manufacturing, our R&D to the supplier's R&D, our procurement to the supplier's sales, etc Supplier Relationship Characteristics Points* Understanding purchase We have detailed spend analytics, e.g., at item/specification level patterns that go beyond traditional sourcing data We understand where value is created and/or is leaked from the Mapping the value chain end-product back to the original supply source Information and Analyzing and modeling We have the ability to determine the system-wide impact of **Analytical Capabilities** options changes to supply We exchange up-to-date information with our suppliers, e.g., re: Exchanging information forecasts, inventory levels, orders, shipments, etc., and have intealong the value chain grated our product design systems with suppliers Information and Analytical Capabilities Points* We have a category management structure that provides global Globally coordinated catintegration internally as well as a unified face and global reach into egory management the markets We have supply management professionals with technical category Skills beyond traditional Organization and expertise, research and analytical skills, "soft" skills, and program Human Resource sourcing and project management skills Management We have a career path in supply management that allows for devel-opment of skills beyond traditional sourcing and retention of supe-Future considerations rior individual performers

Organization and Human Resource Management Points*

VFS readiness assessment — Summary Scorecard

Assessment for category: _

Enablers	Points Possible	Your Points	Кеу	
Executive Engagement	20		15-20 = Ready; 10-14 = Some Issues; <10 = Major Obstacles	
Value Chain Goal Alignment and Measurement	16		12-16 = Ready; 8-11 = Some Issues; <8 = Major Obstacles	
Supply Market Understanding	8		6-8 = Ready; 4-7 = Some Issues; <4 = Major Obstacles	
Collaboration Approaches	8		6-8 = Ready; 4-7 = Some Issues; <4 = Major Obstacles	
Supplier Relationship Characteristics	16		12-16 = Ready; 8-11 = Some Issues; <8 = Major Obstacles	
Information and Analytical Capabilities	16		12-16 = Ready; 8-11 = Some Issues; <8 = Major Obstacles	
Organization and Human Resource Management	12		9-12 = Ready; 5-8 = Some Issues; <5 = Major Obstacles	
Total	96		In general, a score over 72 indicates readiness for VFS; between 48 and 71 indicates some issues; less than 48 indicates major obstacles	

Appendix C:

Interview Guides

The following pages include the two interview guides the study team used during the research.

Achieving Value Focused Supply

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

Interview Guide #1: Case Example

Selecting the category

- 1) Please describe the strategic purchase category we will be discussing in this interview and why you decided to pursue VFS for it.
- 2) Who was involved in the decision to pursue VFS for this category?

Establishing value creation objectives for the category

- 3) What value-focused goals related to VFS do you have in place for the category?
- 4) What specific metrics are you using to track the results of the strategy?
- 5) How are the results verified and validated?
- 6) Who is accountable for results?
- 7) What results have you achieved to date?

Developing and implementing the category strategy

- 8) What is included in the strategy for the category?
- 9) What approach did you follow to develop the strategy?
- 10) Did you follow any accelerated change management approach to develop and implement the strategy, and if so what was it?

Evaluating, measuring and rewarding success

- 11) How successful has VFS strategy implementation been in creating value?
- 12) How satisfied are you with the quality of the strategy that was developed?
- 13) What changes have you or your suppliers had to make to the strategy or the tactics to successfully implement them and to what extent were these not planned for?
- 14) What factors if any are constraining/limiting higher performance and how?
- 15) To what extent are the processes and the lessons learned from this experience being captured and shared for use with other categories?
- 16) When you look back on the effort to develop and implement a value-based strategy for this category, how did your company's culture and management style help or hinder the approaches you took?
- 17) What was the most successful part of the strategy? What was the biggest surprise or unexpected finding? What was your biggest disappointment about the effort? What was your biggest learning about what to do differently next time?
- 18) Would you be willing to allow the research team to contact a key supplier for this category to obtain the supplier's perspective on the VFS process and results?

Achieving Value Focused Supply

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Interview Guide #2: General VFS process

Defining value creation opportunities from supply and suppliers

- 1) To what extent are the company's business strategy and general market conditions redefining/reshaping the role of supply in delivering value?
- 2) How does your company decide which categories to focus on strategically? What factors are considered? (taking into account both spend levels and other ways purchasing/supply and suppliers could contribute additional value to overall business goals)
- 3) What are the 3-4 key (i.e.; most strategic categories) that you manage? What specifically makes those categories "key"?
- 4) What kinds of value are senior executives expecting supply to deliver from these categories and what metrics do they use to evaluate success? Which are the top five sources of value in importance (rank order and weights)?
- 5) What type of mandate does procurement have for identifying and proposing opportunities for more value from the supply base?
- 6) What is your company's philosophy towards the role that suppliers should play in delivering value for key categories?

Developing and implementing strategies for value creation

- 7) Referring to the model on the following page, how does your approach to VFS strategy development compare with it? Which parts did you do (please elaborate on how)? Were there any of these that you explicitly decided not to include in your process? Why? Were there other steps that are not on the list?
- 8) How and at what points in the process is executive management (non-supply) involved in the development, review and enhancement of category strategies for strategic items?

	For each key category							
Segment the overall spend portfolio and supplier portfolio, and screen for value potential based on business strategy, business unit and product- service line	Carry out detailed fact finding to determine value levers including "Five forces," value chain structure, TCO, supplier capabilities, technology roadmaps, supply constraints, risk exposure	Establish goals and targets for value capture including innovation and growth, value chain restructuring, advanced cost management and business continuity and risk management	Develop strategies and tactics including ones that anticipate and fulfill technology needs, optimize use of internal and external resources, disrupt or influence supply markets, and increase company's attractiveness as a business partner	Plan implementation including costs and investments, timing and sequencing of actions, accountabilities, staffing and skill requirements, metrics and benefits tracking process, governance process and strategy documentation and communications	Manage implementation to ensure achievement of individual project goals within procurement, across functions and with suppliers, and to coordinate timing and interactions for the overall program	Measure value based results and take corrective actions, including tracking predictive measures that signal the need to adjust or re- examine the strategy		

Enabling Value Focused Supply

- 9) What actions have you taken relative to organizational or HR capabilities, culture or behavior, management processes and knowledge/IT management to better enable this process?
- 10) What still needs to be improved in your company's current category strategy development processes to make a more significant contribution to the overall competitive success of your company? How willing is your company to invest to do so (people, time, travel, budget)?

CAPS Research

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