1

The Next Level—an Overview for the C-Suite and Supply Management Leaders

One of our favorite questions to ask an audience is this: "Please raise your hand if you believe that most senior executives around the world understand the enormous potential of modern supply management." At best, 10% of the audience raises their hands. The follow-up question takes the next logical step: "Keep your hands raised if you believe that those same executives understand how to achieve that enormous potential—how to build the transformation roadmap." Typically, no hands remain raised.

Is this an indictment of most senior executives? Or is it an indictment of supply management leadership for failing to create executive awareness and develop the business case for what is possible? Or is it both?

This chapter addresses these tough questions. It offers real-world ideas on getting top management's attention to the potential of supply management by highlighting the bottom-line implications. That's followed by the overview of a set of guidelines, or *dimensions*, for transforming supply management from a transaction-based, reactive function to a powerful strategic force. Included in this discussion is practical advice on selecting the right organizational design to support the transformation effort as well as a discussion if *good is enough* is really good enough.

What Is Meant by Transformation?

It seems that every conference speaker, and every company, is touting *transformation*. It has become such an overused word that it is beginning to lose its meaning. Let's start the discussion with a brief review of two fundamentally different definitions.

Webster's defines the word *transform* as a change in composition, structure, character, or condition, "to change the outward form or appearance." That strikes us as a superficial, skin-deep definition. Now consider this alternative perspective. To transform means to fundamentally alter the capabilities and improve the achievement of sustainable results. That seems to us to be more in line with what organizations really should want to achieve. It is the latter definition that we employ throughout this book.

Figure 1.1 provides some depth to what we want to transform *from* and what we want to transform *to*. At a broad level, this transformation can be best described as moving from a tactical perspective to one that is strategic. Transformation is a complex construct with many dimensions.

Speaking the Language

Senior executives might stay awake at night for any number of work-related reasons. Based on our own experiences, the top sleep disrupters typically revolve around these issues:

- Can the company meet or exceed earnings and performance expectations?
- Can we grow revenues and earnings year-over-year?

Role	Tactical	Strategic
Organizational level	Back office, transactional	Executive–Seat at the Table
Metrics of success	Meeting headcount objectives, transactional efficiencies	Revenue enhancement, cost reduction, working capital, ...
Skills	Paper processing, clerical, …	Leadership, cross-functional, cross-cultural, strategic, analytical, …
Career path	Lifetime	Candidates for high-potential job rotations throughout the company
Job content	Boring, repetitive	Creative, substantial impact, fun
Other	Lone ranger	Team player, strategic business partner

Figure 1.1 A key question: Transform to what?

- Are we able to reduce risk and volatility in revenues and earnings?
- How can we continually improve return on invested capital (ROIC) or return on equity?
- How can we create a unique business model, one that is difficult for competitors to copy?

The surprising fact is that a successful supply management transformation can favorably impact all five of the performance areas imbedded in these questions. As a corporate function, it is uniquely positioned—more so than most functions—to have a broad and sustainable impact on the business. The sad fact, though, is that most senior executives are unaware of this potential. A big reason for this lack of awareness is that no one has communicated the opportunity in his or her language. Awareness doesn't just happen by itself. The central challenge for supply management professionals, then, is to take a leadership role in helping their senior management understand.

Toward this end, every chief supply chain officer (CSCO) or chief procurement officer (CPO) needs to be conversant with the performance improvement framework shown in Figure 1.2. This is one of our favorite charts and is the essence of relating supply management to improved corporate performance. Let's walk through this framework briefly—a more involved discussion appears in Chapter 4.

Two important measures of corporate performance are ROIC and cash flow. ROIC is calculated by taking the annual earnings of a business and dividing it by the total capital invested in that business (long-term debt and stockholder's equity). ROIC is important because it is an indicator of the current health of a business. For a business to deliver value to its shareholders, ROIC needs to exceed the corporate cost of capital. A company that operates where its ROIC is lower than its cost of capital is essentially liquidating itself.

Improving profits helps to improve both ROIC and cash flow. Reducing the capital intensity of your business also helps to improve ROIC and cash flow. Improving profits while also reducing the capital needed to run the business has a powerful compounding effect on ROIC and cash flow.

So how do we go about improving profits? There are two fundamental ways: revenue enhancements and cost reductions. Supply management can—and should—play an important role in each of those areas, as indicated with examples shown in Figure 1.2. Supply management should, for example, take a leadership role in creating a more responsive supply chain, thereby helping the company to win more business (and increase revenues) from customers. Supply management should also take the lead applying good processes to better manage all areas of spending, not just those typically assigned to procurement.

So far so good, but how do we reduce capital intensity? Again, there are two ways: working capital improvements and capital expenditure improvements. Once again, supply management can play an important role in each of those

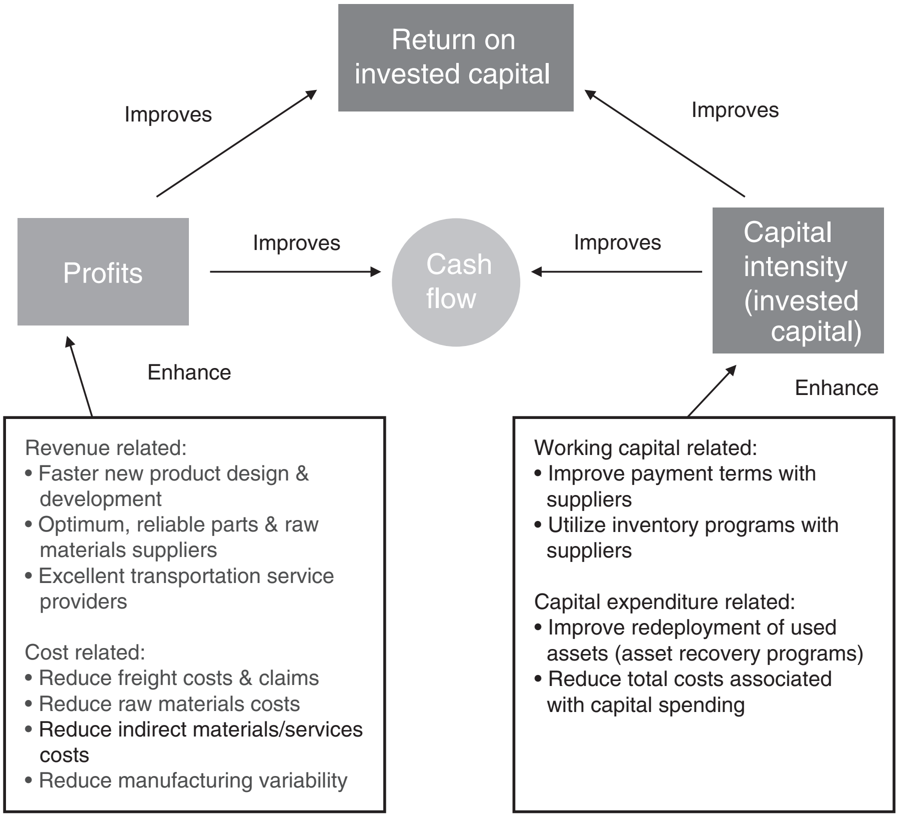

Figure 1.2 World-class supply management drives performance
Source: Greybeard Advisors LLC.

areas. In many companies, for example, there is no clear responsibility for analyzing and coordinating supplier payment terms. This area is ideally suited for supply management to take a lead role, as is pointed out in a later chapter on working capital. With regard to capital expenditures, experience demonstrates that the sooner procurement is involved in new projects (even at the concept stage), the better the overall project economics and ramp-up time will be.

A thorough opportunity assessment for supply management requires a careful evaluation of the improvement opportunities in each of the four categories shown on the exhibit. Then, to tie it together for the executive audience, you relate those improvement opportunities to the company's income statement and balance sheet. Going that extra step allows you to demonstrate the impact of supply management on net income, earnings per share, ROIC and cash flow—all key areas of interest for senior executives. It's a powerful way to communicate the enormous potential of a transformed supply management organization in the language of senior executives and in a manner relevant to your company.

Each situation is unique. However, in our experience it's not unusual for a well-done opportunity assessment to demonstrate that a company's ROIC has the potential to double or triple from its pre-transformation levels. The next logical question is, "If that's the case, why aren't there many 20% ROIC super-performers in the business world?" The answer is painfully simple. Achieving that step-change in performance doesn't just happen by itself. It takes leadership and a well-designed, well-planned transformation roadmap.

Dimensions of a Successful Transformation

Supply management transformation refers to the successful conversion or metamorphosis of supply management from a transaction-based, reactive function to a pro-active, strategic driver of business performance—whose input is regularly sought by other areas of the company.

Companies that have successfully transformed their supply management activities into world-class performers have paid attention to six key dimensions of transformation. As shown in Figure 1.3, those dimensions are procurement's role, objectives, leadership, organization, best practices, and innovation and technology. Underlying these six dimensions are more than 30 specific

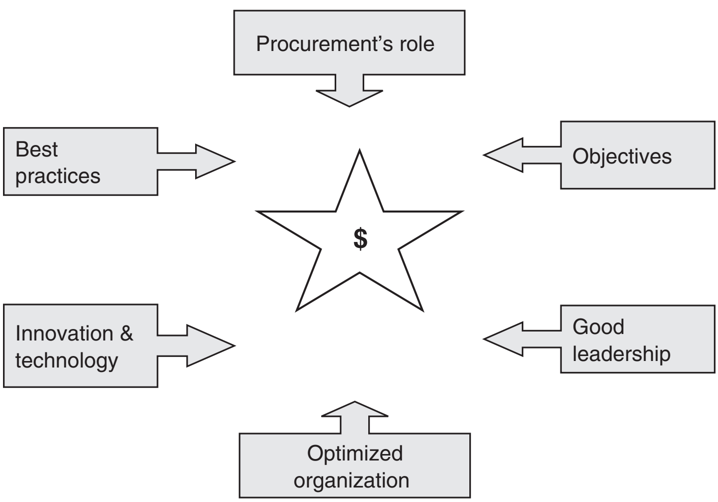

Figure 1.3 Six dimensions of successful transformation

Source: Robert A. Rudzki, Douglas Smock, Michael Katzorke, and Shelley Stewart Jr., *Straight to the Bottom Line*. Fort Lauderdale, FL: J. Ross Publishing, 2005.

initiatives that ultimately comprise a comprehensive transformation plan. (A more detailed discussion of the *star chart* transformation framework appears in Chapter 3.)

Before you even start thinking about which initiatives to focus on, you need a strong leader in place to sponsor the transformation process. The logical place to look is the head of procurement or supply chain management. If that person is not comfortable in a leadership role, then you'll need to look elsewhere. It's a sad fact that not enough people are comfortable in leadership roles. (Lee Iacocca's book, *Where Have All the Leaders Gone?*, is a great read on this subject.)

Simply stated, the transformation leader has to be willing to advocate change, which often means putting his or her neck on the line. Here's what we mean. First, he or she will need to develop a bold vision with stretch objectives that relate to the interests of senior management. And again, these objectives must be communicated in the language of the executive suite. The transformation leader must also be willing to lay out a specific transformation plan and roadmap, with concrete milestones that feature achievements rather than just activities.

Perhaps most importantly, the transformation leader must be willing to construct a business case that offers a performance commitment (that is, $X million of new cost reductions to the bottom line in each of the next few years) in exchange for the executive support (budget, people, outside support, tools, and systems) needed to make it happen. Without that show of confidence and commitment by the transformation leader, why would the rest of the executive team be willing to commit people and budget to the effort?

When one of the authors of this book was a corporate CPO, he did exactly what we're describing—and it made a huge difference to bottom line results. This approach helped create the excitement and commitment within the organization needed to energize the transformation. Believe it or not, once you're willing to go down this path, and once you are comfortable with the leadership imperative, the rest is easier than it might seem.

The Organizational Chart Diversion

One dimension of the transformation effort, organizational governance and design, demands special attention because of its potential to make or break the effort. Let's take a closer look, drawing on material from *Beat the Odds: Avoid Corporate Death and Build a Resilient Enterprise*.

To set the stage, consider the following scenario, which you may have actually experienced yourself. A company is experiencing overall performance problems that just don't seem to go away. The senior management team decides that the organization structure is at fault, and that a corporate reorganization will give the necessary boost to performance. Soon, the consultants arrive, and they draw up a whole new organization chart. New divisions are created on paper, management councils are designed, reporting relationships are changed, and job descriptions are re-written. Much time and money are spent on correcting things that may not have been broken in the first place. Management breathes a sigh of relief, thinking that the performance problems are about to be solved.

Yet performance does not measurably improve. In fact, it worsens. Employees become disenchanted with senior management for not fixing things and start losing their focus. Although a poor organizational design can impede success, organizational design is rarely a driver of success. Furthermore, the temptation to apply the *organizational chart fix* to an enterprise ignores an important reality: the informal relationships and networks inside an organization are often more important than the formal reporting structures and charts. Moreover, these informal ties are guided more by the organization's purpose, values, and vision than they are by the consultants' new chart. This holds true whether we're talking about the overall corporate organization or the supply management function specifically.

The message in all of this should be clear: Before redrawing the supply management organization chart, it is much more productive to first address the role, objectives, leadership, and best practices dimensions. Build your transformation game plan for each of these critical dimensions before tackling the organizational issue and the specific enabling technology.

With the right role, objectives, leadership and best practices in place, or at least planned, the foundation is created for success. You now can view organizational design in terms of your corporate culture and what you want to achieve through supply management. Put another way, you can view organizational design in a strategic, transformation context.

Thinking about this subject, author Rudzki distinctly remembers attending a CPO peer group meeting a few years ago when the discussion turned to organization. One of the attendees offered this solution to the various challenges being raised by the audience: "Procurement should be centralized, and all other corporate functions should also report into us." As you can imagine, that idea drew quite a round of laughter (even though some of the CPOs at the meeting would have liked to give it a try). But that bold suggestion did bring up some important questions: Can a centralized procurement function work well in a decentralized corporate culture? Can a decentralized procurement function ever be as effective as a centralized one? Who should procurement report to in the corporate hierarchy? These are all good questions.

At a broad level, what is the ideal organization design for supply management? There is no single answer, contrary to what many hope and expect. Yet the classic options basically boil down to three: centralized or centrally-led, hybrid, or decentralized. (Figure 1.4 lists the advantages and issues of each approach.) In general, a truly decentralized supply management organization

	Description	
• Strong, unified professional procurement organization • Solid line reporting to head of procurement • Accountable to entire organization and to each business unit	• Small central staff serves policy, training, and coordination needs • Strategic procurement personnel serve entire organization • Tactical/transactional staff located at local facilities • Dual reporting of local personnel to local management and to corporate head of procurement	• Separate procurement organizations • Dotted line reporting to corporate head of procurement • Some degree of informal coordination and collaboration
	Features	
• Rapid adoption of best practices • Best for scale, leverage, and results • Less personnel required to accomplish objectives	• Can provide opportunity to build synergies across company while sensitive to each business unit • Can be complex to administer • Critical success factor: strong leadership and alignment of objectives	• Difficult to implement best practices • Less scale and leverage, weaker cost reduction results • More personnel required to accomplish objectives

Figure 1.4 Main organization types

Source: Robert A. Rudzki, Douglas Smock, Michael Katzorke, and Shelley Stewart Jr., *Straight to the Bottom Line*. Fort Lauderdale, FL: J. Ross Publishing, 2005.

has difficulty delivering world-class results in an efficient manner. Enterprise-wide leverage and coordination is more difficult, and often more resources are deployed across more locations than would otherwise be necessary.

That's the reality. But believe it or not, some companies may not care. We've talked with CPOs who work for profitable companies. Their executive teams aren't showing much interest in optimizing supply management performance through strategic consolidation of key activities. Eventually, they will change their perspective if business conditions change.

A fully centralized supply management organization can present some challenges too, depending on internal corporate culture. Even if the overall corporate structure favors centralization, a centralized supply management function still must be responsive to the needs of the individual businesses. The satisfaction of your internal clients (your executives, business unit leaders, and other key internal stakeholders) is paramount—whatever structure is selected.

Hybrid structures are popular because they allow you to build and coordinate synergies across the company while being sensitive to each business unit's unique needs. This is often accomplished by co-locating procurement personnel both at corporate headquarters and at the business operations. In many cases, these individuals have dual reporting responsibility to the local operations or finance head and to the corporate CPO.

Regardless of which option ultimately proves to be the best for your situation, consider applying these two proven techniques: creation of an executive steering committee and a procurement council. The steering committee is typically comprised of senior executives, who represent corporate functions and business units. The committee provides high level oversight and support of the transformation initiative. In the best of all worlds, members of the steering committee also act as sponsors of individual sourcing teams. Their involvement can send a powerful message of commitment, both internally and to suppliers.

The procurement council typically is comprised of the CPO and his or her direct reports in the supply management organization. It can be a valuable forum for driving change, sharing best practices, assuring alignment, and spurring results. We have witnessed procurement councils achieve these very goals, greatly advancing the overall transformation effort.

One last question should be asked with regard to organizational design. Should supply management report directly to the CEO? Direct reporting is really a two-edged sword. On the one hand, the CPO has direct access to the top executive in the organization. But on the other, this reporting relationship could result in a diminution of focus on the supply management ball.

Consider what happened to one CPO who was made a direct report to the CEO. He started getting invited to many staff meetings unrelated to his job. Most of the discussion at those meetings, he felt, was a waste of his time and a distraction from his core responsibilities. The key to supply management success is not the lines on the corporate organization chart. The real key is access. The CPO should have regular and easy access to the executive suite and to the heads of the business divisions. Chapter 5 takes the organizational design discussion to the next level.

Skin in the Game

One last ingredient of a successful supply management transformation is what we call *skin in the game*. This refers to the importance of having the interests of key stakeholders and participants linked to the objectives of the transformation process. You might think of skin in the game as the mechanism to increase the likelihood that all the pieces—and all the players—work smoothly together.

Skin in the game can be manifested at different levels. At a minimum, it starts with incorporating objectives of the transformation plan into the annual, written performance objectives of relevant employees. By relevant employees, we mean everyone from the CEO to the entry-level buyer—from procurement professionals to internal clients. Anyone who can influence the success of the transformation process should have some skin in the game.

The next step is the linking of personal objectives to meaningful financial incentives and consequences. One company we have worked with ties a significant percentage of its annual bonus program to the success of the procurement transformation plan. The program sets annual milestones on key dimensions of the plan, including quantifiable cost reductions.

Meaningful incentives can be effective in encouraging superior performance and achieving objectives. However, what about the individual *blocker* who just won't participate, or worse, actively works against the transformation? We have encountered such troubling situations a few times during our careers. When the particulars of one specific instance were discussed with a top executive at the company, his response was straightforward: "That's why we have flagpoles. Not just to rally the troops for a good cause but, if necessary, to hoist the recalcitrant party up in the air so everyone can see the example." Though this response is a little harsh, the point is well made.

The underlying message is that you need to address problems quickly and publicly. A reluctance to deal with noncompliance is a big reason why transformation efforts get derailed. That's not to say that you look for people to serve up as examples. First, try to understand why the individual appears to be blocking the transformation effort by having a conversation with him or her. Second, determine what's driving the behavior. Make absolutely certain that the individual has all the necessary facts at his or her disposal. You may discover that their reluctance to comply is based on some fundamental misunderstanding or a perception that they're being left out.

In the final analysis, you don't want reluctant compliance. You want active commitment. And that really is the litmus test of supply management

Traditional purchasing:

- Potential of 0–3% price reductions

World-class supply management:

- Potential of 5–10% total cost reductions for direct spend
- Potential of 10–40% total cost reductions for indirect spend
- Revenue enhancements—better able to compete for sales with a more responsive supply chain
- Improved cycle time for new product/service development
- Working capital improvements
- Improved market knowledge for company-wide benefit
- Better risk management and enhanced business planning
- Improved ROIC/ROE, cash flow, and EPS

Figure 1.5 Supply management transformation offers big benefits transformation. Genuine transformation produces significant, sustainable results both near-term and long-term, as shown in Figure 1.5. Moreover, it does so by creating an enormous amount of positive energy and commitment from all areas of an organization. Without that, you might be stuck with a few *quick wins* that eventually disappear, along with you and your company's credibility.

Is *Good Enough* Good Enough?

The title of this section derives from a theme that arose initially in the technology world: is *good enough* good enough? In one application of this idea, it has been suggested that software developers deliberately leave bugs in the code so as to shorten the schedule for product delivery (recognizing, of course, that the bugs can be corrected in the next product release). Others define it as providing the minimum quality that you can get away with.[1]

Some would say that the Mars Rover program was a positive example of this philosophy at work. Rather than design the ultimate Rover research vehicle at untold cost, NASA focused on the key functionality that it needed to accomplish mission objectives and spent much less money by having an 85% solution, rather than a 110% solution.

This section looks at the *good enough* topic from more than a *purchase of software* perspective, consistent with the six dimensions of supply management transformation described in this book.

Why Is There an Issue?

In our experience, too many executives seem to take an approach toward procurement and supply management that is equivalent to adopting a satisfactory or good enough approach. Commonly, this manifests itself as an organization in which supply management demonstrates some or all of these characteristics:

- Has a tactical or operational role
- Has informal and soft objectives with no profit and loss relevance
- Utilizes traditional day-to-day purchasing tactics as opposed to strategic practices such as strategic sourcing
- Tends to be consumed with tactical activities and is unable to devote sufficient time and attention to strategic initiatives
- Is micromanaged rather than led
- Lacks cross-functional involvement and support
- Has relatively few modern processes, skills, tools, and systems to enable its evolution into a sustainable value creator

Organizations that fit this description leave considerable value on the table, leave themselves open to competitive threats from others in their industry