Supply Management Transformation: A Leader's Guide

By Robert A. Rudzki

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Senior management may stay awake at night for any number of reasons. But what they may not realize is that many of the worries causing them sleep depravation can be alleviated by a solid supply management operation. But creating that kind of organization requires a transformation—from a reactive, transaction-oriented function to a strategic entity. Here is some practical advice on how to start making that transformation.

When presenting at a conference, one of my 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 percent 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 we can do? Or perhaps both?

This article addresses those tough questions. It offers real-world ideas on getting top management's attention to the real potential of supply management by highlighting the bottom-line implications. That's followed by the presentation 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.

Speaking the Language

Let's start with the observation that senior executives might stay awake at night for any number of work-related reasons. Based on my own experiences, the top sleep disrupters typically revolve around the following issues:

- Can the company meet or exceed earnings and performance expectations?
- Can we grow revenues and earnings year-over-year?
- Are we able to reduce risk and volatility in revenues and earnings?
- How can we continually improve return on invested capital

Dave Cutler

(ROIC) or return on equity (ROE)?

• How can we create a unique business model, one that is difficult for competitors to copy?

The surprising fact is that successful supply management can favorably impact all five of these 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. A big reason for this lack of awareness is that no one has communicated the supply management opportunity in their 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 CPO or chief supply chain officer needs to be conversant with the performance improvement framework shown in Exhibit 1. This is one of my favorite charts, and is the essence of relating supply management to improved corporate performance. Let's walk through this framework carefully.

Two important measures of corporate performance are return on invested capital (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 create value to its shareholders, ROIC needs to exceed the corporate cost of capital.

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.

Ok, 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 Exhibit 1. For example, supply management should take a leadership role in creating a more responsive supply chain, thereby helping the company to win more business (and increase revenues) from customers. Similarly, supply management can take the lead in applying good processes to better manage and lower costs across all areas of spend, 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 areas. To cite one example, in many companies there is no clear responsibility for analyzing and coordinating supplier payment terms. This is an area ideally suited for supply management to lead. With regard to capital expenditures, experience demonstrates that the sooner supply management is involved in new projects (even at the concept stage), the better the overall project economics will be.

A thorough opportunity assessment for supply management requires a careful assessment of the improvement opportunities in each of the four categories shown on the exhibit. Then, to really tie it together for the executive audience, you need to 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, on earnings per share, on ROIC and on cash flow—all key areas of interest for senior executives. It's a powerful way to communicate the enormous potential of modern supply management in the language of senior executives and in a manner relevant to your company. It's also critical for building a credible business case in support of a supply management transformation.

Each situation is unique. However, 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. But then the next logical question is, "If that's correct, why aren't there a lot more 20 percent 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 and planned transformation roadmap.

Dimensions of a Successful Transformation

What do we mean by "supply management transformation"? Basically, it's the successful conversion or metamorphosis of supply management from a transaction-based, reactive function to a proactive, strategic driver of business performance—whose input is regularly sought by other areas of the company.

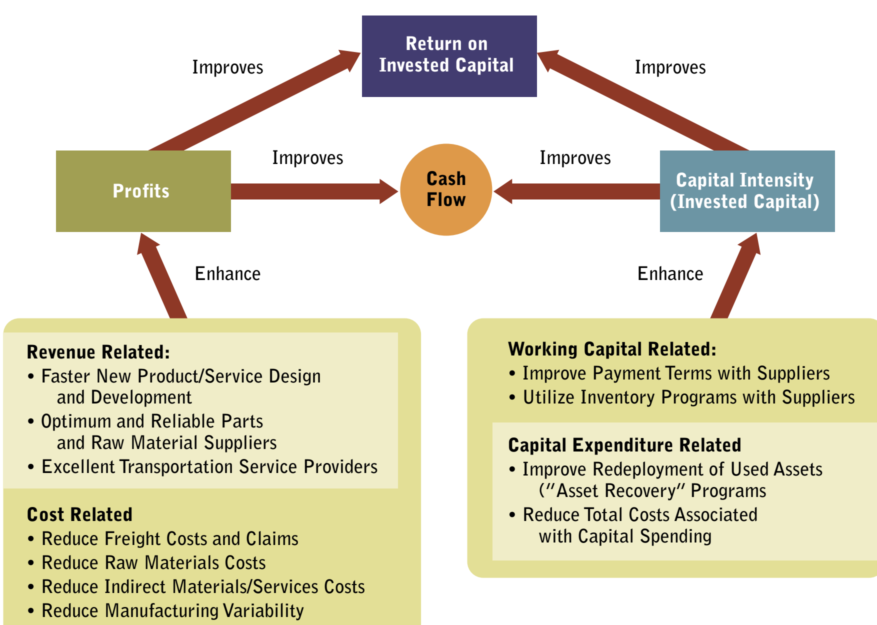
Companies that have successfully transformed their supply management operations into world-class performers have paid attention to six key dimensions of transformation.

As shown in Exhibit 2, those dimensions are procurement's role, objectives, leadership, organization, best practices, and innovation and technology. Underlying these six dimensions are more than 30 specific initiatives that ultimately comprise a comprehensive transformation plan.

For most companies, it's probably impractical to try to advance across all 30-plus initiatives from the very beginning of the transformation effort. You need a carefully thought-out roadmap that takes into account your current position (the so-called

EXHIBIT 1

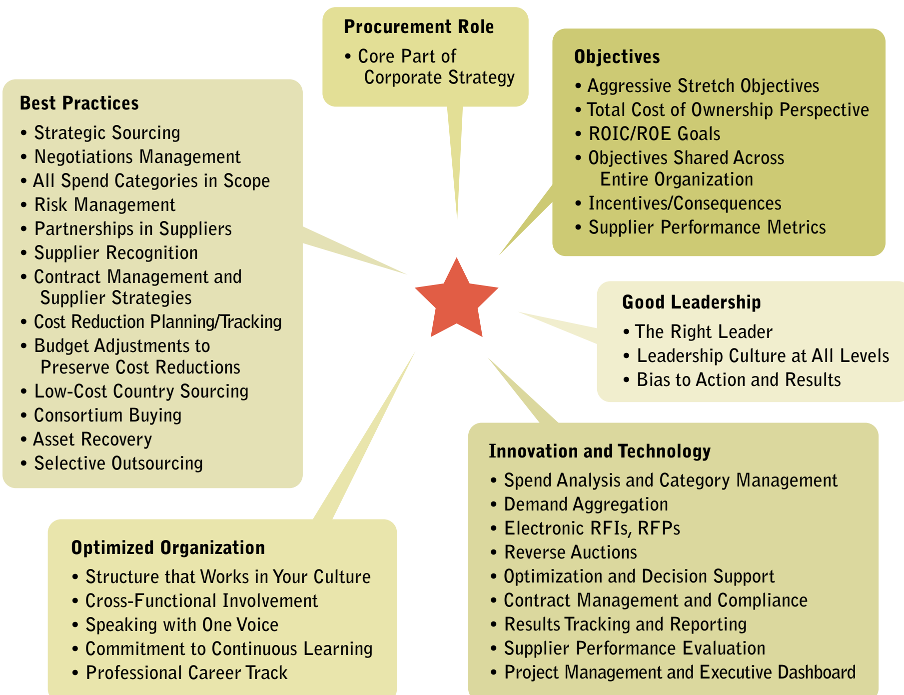
World-Class Supply Management Drives Performance



Source: Greybeard Advisors LLC.

EXHIBIT 2

Six Dimensions of Successful Transformation



Source: Straight to the Bottom Line, J. Ross Publishing, 2005

"as is" state) and establishes a logical sequence of initiatives that build on each other. From personal experience and my work in guiding clients, I can say with certainty that this task involves both art and science.

You might wonder, Why not keep it simple and focus on just one initiative—say, strategic sourcing? Some companies have done that, focusing on that singular theme as their path to glory. Yet often, after an initial flurry of quick wins, those companies see their gains evaporate as the program falters. The reason: Such single-focus programs often lack the necessary pillars of support for a successful, sustainable transformation across those six dimensions described above.

Before you even start thinking about which initiatives to focus on, though, 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 new 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—and put his or her neck on the line. Here's what I 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 be willing to lay out a specific transformation plan and roadmap, with concrete milestones (achievements, not just activities).

Perhaps most important, 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, and tools/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 I was a corporate CPO, I did exactly what I'm describing—and it made a huge difference. This approach helped to 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, once you are comfortable with the leadership imperative, the rest is easier than it might seem.

With regard to the other key dimensions, a critical element of success or potential failure relates to the role that supply management plays in the organization. Companies that make procurement and supply management a core part of their corporate strategy are more likely to produce great results. In my experience working with companies, I've observed that's it's much better to establish supply management in a strategic role if the comprehensive opportunity assessment has been conducted and a credible business case for transformation has bean made.

The next area of attention relates to the dimension of objectives. It's important to have stretch goals that are based on a total cost of ownership perspective, or ROIC goals. And it's critical that these objectives are shared across the entire organization. Stated another way, not sharing the supply management objectives with other key functions diminishes the chances that the transformation effort will succeed.

There are about a dozen key best practices, as noted in Exhibit 2. Note that strategic sourcing is just one of the practices that need to be understood and implemented with rigor.

Innovation and technology is a key enabler of the whole transformation initiative. The technology functions shown in the exhibit can provide significant value to your activities. Perhaps most important, solutions available today are proven and well-integrated to ensure that the savings negotiated up front by procurement actually make it to the bottom line.

The Organization Chart Diversion

"We trained hard … but it seemed that every time we were beginning to form up into teams, we would be reorganized. I was to learn later in life that we tend to meet any new situation by reorganizing; and a wonderful method it can be for creating the illusion of progress while producing confusion, inefficiency and demoralization."

— Petronius Arbiter, circa 210 BC

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

Although a poor organization design can impede success, an organization design is rarely a driver of success.

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. In come the consultants and they draw up a whole new organization chart. New divisions are created on paper, management councils are designed, reporting relationships are changed, new job descriptions are re-written. Much time and money are spent on "correcting" things. 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. They start losing their focus. (Keep in mind that quote from Petronius Arbiter.)

Although a poor organization design can impede success, an organization design is rarely a driver of success. Furthermore, the temptation to apply the "org chart fix" to an enterprise ignores an important reality: the informal relationships and networks inside an organization are often more important than hierarchical organization charts. Moreover, these informal ties are guided more by the organization's purpose, values, and vision than they are by the consultants' spiffy new org 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: Before redrawing the supply management organization chart, it is much more productive to first address the role, objectives, leadership, and best practices. Build your transformation game plan for each of these critical dimensions before tackling the organization issue, and the specific enabling technology.

With the right role, objectives, leadership and best practices in place (or, at least, planned), you lay the foundation for success. You now can view organization 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.

Three Design Alternatives

But what is the ideal organization design for supply management? There is no single answer, contrary to what many hope and expect. Yet the options basically boil down to three: centralized, hybrid, and decentralized. (Exhibit 3 lists the advantages and issues associated with each approach.) Determining which one is right for your organization requires careful analysis and thought. What follows is a description of each option, which are detailed in a book I co-authored, *Straight to the Bottom Line*.

In general, a truly decentralized supply management organization has difficulty delivering world-class results in an efficient manner. Enterprise-wide leverage and coordination can be difficult in a decentralized environment. In addition, decentralization often means that resources are deployed across more locations than would otherwise be necessary.

That's the reality of decentralized supply management. Believe it or not, some companies may not care: I've talked with CPOs of several companies that are making a lot of money right now. Their executive teams aren't showing much interest in optimizing supply management performance through strategic consolidation of key activities. Eventually they will, of course, as business conditions change.

A fully centralized supply management organization can have some challenges, too, depending on internal corporate culture. But even if the overall corporate structure favors centralization, a centralized supply management function still must be responsive to the needs of the individual businesses. Being centralized is no excuse for being dogmatic or arbitrary (or sitting in an ivory tower). The satisfaction of your internal clients (your executives, business unit leaders, and other key internal stakeholders) is paramount—whatever structure is selected.

EXHIBIT 3

Main Organization Types

	Centralized	Hybrid (Center-Led)	Decentralized
Description	• Strong, unified professional procurement organization • Solid line reporting to head of procurement • Accountable to whole organization and to each business unit	• Small central staff develops policy, training coordination needs • Strategic procurement personnel serve entire organization • Dual reporting of local personnel to local management and to corporate head of procurement	• Separate procurement organizations • Dotted line reporting to corporate head of procure-ment, if there is one • Some degree of informal coordination and collaboration
Features	• Rapid adoption of Best Practices, such as e-sourcing • Best for scale, leverage and results • Usually only possible with strong, highly respected CEO	• Can provide opportunity to build synergies across company while sensitive to each business unit • Politics can be brutal • Critical success factor: strong lead-ership and alignment of objectives	• Difficult to implement Best Practices • Less scale and leverage, weaker cost reduction results • More personnel required to accomplish objectives

Source: Straight to the Bottom Line, J. Ross Publishing, 2005

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, representing corporate functions and business units. The committee provides high-level oversight and support of the organizational 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 representatives from the next level in the supply management organization. Structured properly, the council can be a valuable forum for driving change, sharing best practices, assuring alignment, and spurring results. As a CPO, I've 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 friend and CPO peer who was made a direct report to the CEO. He started getting invited to lots of "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.

Skin in the Game

One last ingredient in a successful supply management transformation is what I 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. As a minimum, it starts with incorporating objectives of the transformation plan into the annual, written performance objectives of relevant employees. By relevant employees, I mean everyone from the CEO to the entry-level buyer—from procurement professionals to internal clients. Anyone who

EXHIBIT 4

Advantages of a Supply Management Transformation

World-Class Procurement and Supply Management

- Potential of 2-10% 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 and EPS

Source: Greybeard Advisors LLC

can influence the success of the transformation process should have some skin in the game.

The next level is the linking of those personal objectives to financial incentives and consequences—and making them meaningful. One company I've worked with takes this to the max by tying a significant percentage of the 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 quite effective in encouraging superior performance and achieving objectives. But, what about the individual "blocker" who just won't participate or, worse, actively works against the transformation? I've encountered such troubling situations a few times as a CPO. When I discussed the particulars of one specific instance with a top executive at my company, someone whose advice I valued, 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 a little harsh, his point was well-made.

The underlying message is that you need to address the problem 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 go looking for people to serve up as examples. First, try to understand why the individual appears to be blocking the transformation effort. Have a conversation with him or her. Attempt to figure out 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 transformation. Genuine transformation produces significant, sustainable results both near-term and long-term. (Exhibit 4 lists some of those powerful advantages.) And 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 your credibility.