OBA

Only The Collaborative Will Survive

Lessons from companies whose supply chains are best prepared for an economic upswing

October 2009

Summary Briefing

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The Office for Business Architecture (OBA) was established by a team of experts to catalyse clients with innovative thinking and foster company to company solutions to todays business challenges.

OBA has the ability to offer clients a unique model of consulting. Companies learn from and solve each others problems. We combine both proven strategy consultants from the world's top management consultancy firms, and a broad network of technical and industry experts from leading multinational companies. We can offer real client insights and go beyond what other traditional consultancies can offer.

Our consulting experience gives clients access to top-tier problem solving and project management skills whilst our technical expertise ensures projects stay grounded in reality, generating actionable and practical advice.

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Preface

Only The Collaborative Will Survive, is the end product of a three month project by **OBA** working in collaboration with **London Business School**. This research builds on our extensive experience of benchmarking companies capabilities and performance. In total, we surveyed over 200 participants from 16 different industries and from different geographical regions.

The data was collected using an online survey of Supply Chain, Operations and Finance Executives.

Our aspiration is to provide a fact base for public debate on topical business challenges - the plus points and the downsides - and to enable business leaders to make more informed and better decisions

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Brief Introduction

The current recession has been a testing time for large & small corporations alike. It has however been preceded by one of the most optimistic times in recent history and such was the positive atmosphere till 2007 that there was an emerging body of thought that was willing to label recessions a thing of the past.

And yet, the impact of the last meltdown was not so far back in the past. Surely, successful organisations would have absorbed the lessons from previous recessions into the very fabric of their supply chains and would be well prepared for the current meltdown. This is the starting hypothesis for this research.

Over and above this hypothesis, we also wanted to uncover tangible characteristics that differentiate the supply chains of companies well equipped to handle recessions compared with their counterparts that may be less well prepared.

But before we review the results of the research, a dig into history might serve as useful context.

Contrasting Approaches

Example 1 – Lucent Technologies[1,2]

Immediately prior to the year 2000 Lucent Technologies was on an enviable growth path. Between 1996 and the end of 2000 Lucent had spent more than $46bn on 38 acquisitions (16 in 1999 alone) as the company continued to strengthen its position as a full spectrum provider in the communications industry. In the process, Lucent's revenues grew from $423 million in the 12 months following its IPO in 1996 to a peak of $38bn in fiscal 1999.

Lucent's strategy in 2000 was geared toward increasing stakes and broadening the scope of its technology offerings – two factors that it considered essential to success. Getting the newest product to market and not losing a sale to a competitor were the main forces driving Lucent at this time. As a result little attention was paid to mounting inventories.

The changed landscape in the telecommunications market took an especially strong toll on Lucent and in the fourth quarter of 2000, Lucent posted a loss of almost $1bn, compared with a profit of $1.08bn in the same year-earlier quarter and a balance sheet inventory position of $6.4bn on $5.84bn of sales. *Together with these results, the company also announced a major restructuring program aimed to rebuild the company for long-term sustainable profitability.* By the end of fiscal 2001, Lucent had recorded $11.42bn of restructuring and one-time charges, including $1.26bn in inventory write downs.

Lucent's supply chain at this time was composed of autonomous sub-supply chains formed by eleven business units. This decentralisation had allowed it to respond quickly to varied demands of its customers across its businesses. But on the flip side, this also meant that Lucent now had 29 factories, 200 commercial warehouses and 1700 freight carriers. With all organisational attention focussed at delivering new products, there was less effort spent on actually gaining visibility into customer demand. This made it difficult for Lucent to adapt to large fluctuations in demand. This adaptability was further impeded by little standardisation in product design, and virtually no communication or inventory sharing between product teams.

In light of the new economic realities, Lucent decided to make sweeping changes to its supply chain. It decided to largely exit manufacturing, unify its product units and form a single new group called Supply Chain Operations group. This initiative was not just the formation of a centralised group – but was actually a radical shift in the way the company approached its strategic objectives. Whereas earlier sales drove manufacturing which drove supply chain activities, the new order was where supply chain drove manufacturing and sales. Motivated by the need to support a more global, more cost conscious, more information driven and faster business model, the creation of this supply chain group was focussed on four themes:

1. Customer intimacy
2. Zero latency – simplifying and eliminating redundant processes and activities in the supply chain that led to delays in responding to the customer
3. Collaborative approach with customers and suppliers
4. Cultural change management – seeking out non-alignment with strategy and addressing these 'drifts' in an open communicative manner

While these changes were being made at Lucent, times continued to be bad for the telecommunications industry till 2003 and Lucent saw its revenues decrease from $21.3bn to $8.4bn over this period. The relentless focus on new strategic objectives was however beginning to already show results. Gross margins in 2003 were up over 230% from year before, increasing to 31%, from 13% in 2002 and 10% in 2001. Over the same timeframe, Lucent's annual manufacturing budget was reduced from $1.9bn to less than $300m, while inventory came down from over $8bn in early 2001 to $630m by Sep 2003. Standardisation of designs and sharing of information changed supplier base from 3000 suppliers (top 1000 of which represented only 40% of the material spend), to end 2003 when 80% of the spend was placed with Lucent's top 60 suppliers.

Lucent's supply chain evolved to be not just a tool to enable efficient execution once business has been secured; it helped to drive sales as a result of the new levels of service and responsiveness made possible by the supply chain.

On April 2nd 2006 Lucent announced a merger with Alcatel.

Example 2 – Covisint [2]

In 1999, when the technology bubble was at its peak, a consortium of some the world's leading auto companies: General Motors, Ford Motor Company, DaimlerChrysler, Nissan and Renault, jointly tried to address the growing costs and gross inefficiencies inflicting the industry.

The dream was clear: link up their supply chains through one common online procurement platform (provided by a company called Covisint). Bringing together some of the main players in the industry, their businesses would be positioned to leverage the power and potential of the Internet to solve industry-specific business problems in real-time. The hypothesis was that having a wide base of suppliers, many of whom were common to all companies would allow their procurement functions to get much better prices for the products and allow rationalisation of their back office teams.

What seemed at first a great idea resulted in a perfect model of what not to do: only 12 of the 40 most important suppliers ended up signing on with Covisint, and many top-level suppliers decided to build private exchanges while talking about a suppliers-operated marketplace that would provide real-time visibility into their supply chains. Tens of thousands of lower-tier suppliers were never brought on-board and technology vendors quickly point out that there was no cohesive strategy and a lack of vision.

In retrospect, even some of the players recognise the dimension of the failure: “Covisint was a terrible idea. Nobody thought it through. (…) it never got off the ground” as Thomas Stallkamp, former President of Chrysler admitted.

What caused this apparently good idea to fail was ultimately the lack of trust from the suppliers and simultaneously the attempt to buy direct materials from suppliers when no previous relationship existed. The lesson here is that merely the presence of bargaining power is not a recipe for supply chain efficiency improvement; in fact it could actually be detrimental to the success of an organisation.

The Objectives Of This Research

If there’s one thing that was conspicuous after the tech-bubble slowdown, it was that a large number of corporations, across business sectors had spent an in-ordinate amount of time, focus & resources on surviving the slowdown – effectively under investing in being prepared for the upswing following the meltdown. Both manufacturing and services firms found themselves ill-equipped when the tide turned and a fair proportion of failures to either survive the downturn or capitalise on the upswing were expectedly attributed to weaknesses in supply chain links.

As our previous examples have highlighted, repeatedly in history, firms which have not taken their eyes off their supply chains have demonstrated both resilience during tough times and sharp footed preparedness during the subsequent upswing.

With these observations in mind, our research initially considered a wide set of characteristics / behaviours with regards to supply chains – with the clear objective of identifying the tangible factors that characterise the winners in any recession. Specifically, we looked at the current recession and have attempted to identify companies, which, despite setbacks have demonstrated resilience and have weathered the winds of recession comparatively better than their peers. It is our contention that these firms are also those which are likely to be best placed to leverage the growth which will follow the current recession.

The Winning Characteristics

As our research progressed, we found that the most significant characteristics / behaviours could be summarised into five broad headings, each of which is discussed below.

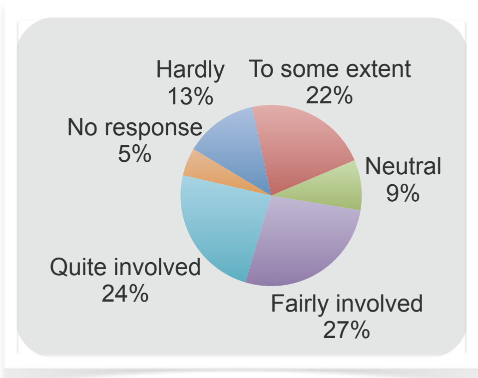
Commitment

Many researchers have long since espoused the merits of senior management commitment to building and sustaining a strong supply chain. Unsurprisingly, we found this a clear distinguishing characteristic for winning firms. For these firms:

a) there was a high level of active engagement with their supply chain partners by senior management (typically the CEO)

   As you can see from the chart below, over 50% of the respondents recognise the hands on approach followed by the Board/Executive Committee when dealing with decisions to be taken on the supply chain.

Is your company's senior management heavily involved in supply chain decisions?



As one respondent shared, the involvement typically escalates when ***"there are strategic or business risk implications with potential Company impact"***

b) more often than not, the supply chain forms a critical part of the overall business strategy - with board representation.

c) and very importantly, senior management retained frequent contact (face-to-face meetings at least once a year) with their key supply chain partners

In other words, winning companies view the supply chain as a critical success factor for overall business performance and ensure that this focus is reflected throughout the organisation from the CEO down. Relationships with key partners were deeper (almost as if it were the same company) and less transactional.

Control

In recessionary times, very often the natural tendency for organisations is to turn inward-looking, focus on protecting themselves and limit the amount of information they share with their supply chain partners. Our research showed on the other hand that winning firms had systems & processes already in place which allowed for an uninterrupted and sometimes increased level of information sharing during recessionary times. In fact, as one would expect, the sharp demand fluctuations that occur during recessions warrant a more integrated organisation (across supply chain entities) that seeks to minimise the bull-whip effect, thus eliminating inefficiencies and balancing supply and demand effectively.

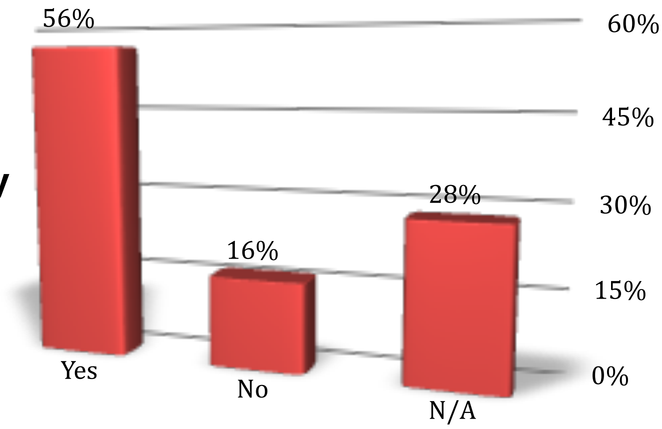
In addition, we found that:

a) winning firms always had clearly articulated back-up plans ready to tackle slippages in all aspects of the business

b) these firms also monitored the health (financial & operational) of supply chain partners at regular, pre-defined intervals and did not restrict partner vetting to initial partnership stages. This helped winners either remove or rectify the poor performance in the supply chain proactively.

Building and strengthening relationships with partners through co-ownership has also improved companies ability to “control” economic uncertainty.

Does your company take an equity stake in key suppliers/partners?



In summary, winning firms displayed more effective control via stronger integration with suppliers in contrast to a more inward looking cost focussed behaviour.

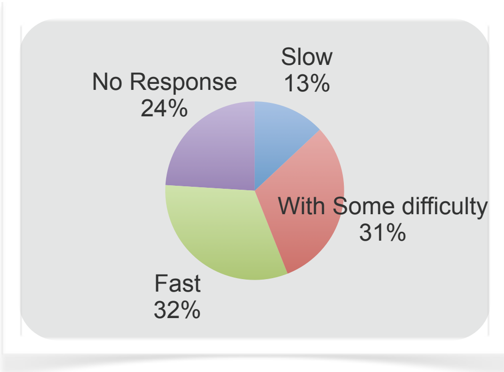
Risk Management

There is no other way to spell it out. Winning firms take contingency planning seriously.

Whenever risk management is "de-prioritised" - particularly forward looking scenario planning - the results during recessionary times can be catastrophic. Our research revealed the following characteristics of good practice contingency planning:

a) there was emphasis on both content & timing – good contingency plans focussed on the ability to react *quickly* to crisis situations

How quickly has your supply chain been able to react to changes as a result of the current economic climate?



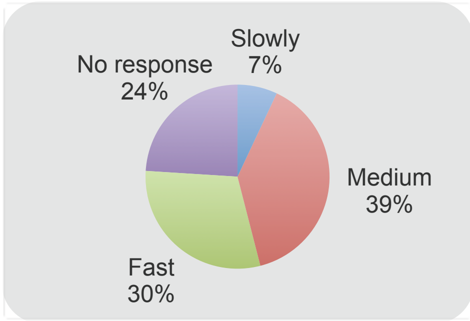
Companies had different levels of preparedness for todays difficult economic situation. Some had taken advantage of the economic peak times to prepare their operations for the typical downturn – "*Cost efficiency programmes were already on the way and current climate only supports this*".

However some of the responses also stress the true globalisation in supply chain's operations: "*We have complex Supply Chains which make it difficult to adopt quickly in the short run. But in some cases we have been able to react fast to adjust to current market conditions. This was true mainly with our company-owned assets*".

b) There was equal emphasis in contingency plans across all components of the supply chain (not only financial risk management):

c) A strong focus was put on the recovery (during the recession) and the way businesses in general will be prepared to take full advantage of the upswing

How quickly will your supply chain react to changes when the economic upswing occurs?



As stated by one respondent: "*Given our scenario work we already now know what handles to pull if there is an upswing in 2010*"

In summary – for winning firms, contingency planning for downside risks is a core part of daily business as well preparing for the upswing **during** recessionary times.

Contracts

In addition to the above, winning firms did not rely solely on legally binding contracts to control or manage there key partners. In times of crisis, what they found most helpful was having long standing (mature) trusting relationships - with an emphasis on a more collaborative and a less transactional style of management.

Contracts with key partners for winning firms also were not one-sided from a reward perspective. Most winning firms had clearly identified the critical players within their supply chains and ensured that these relationships were kept on sound and balanced footing through the use of proper incentives.

Cooperation

Lastly, winning firms work in close collaboration with their supply chain partners:

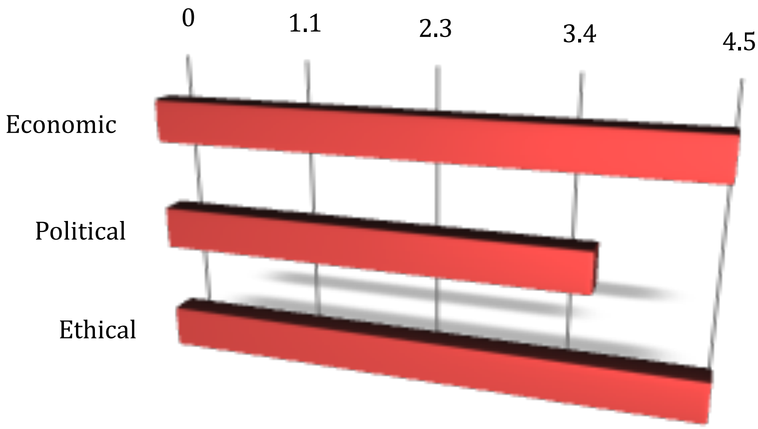
a) in our research we found that winning firms were willing to provide financial support if required to their key partners, usually in the form of re-negotiated contracts

b) also, these firms were of the opinion that information sharing (especially customer demand information and product pipeline information) not only avoids the bullwhip effect, it also demonstrates that the firm is willing to build a longer term relationship with its partners. In other words – information sharing is one key step towards for trust building, a vital ingredient of successful supply chains.

Ethics Vs Economics

Lastly, when asked to rank the most important considerations for their supply chains **<u>during</u>** the current crisis, winning firms clearly indicated their preference for economic **<u>and</u>** ethical considerations. i.e. the manner in which firms engage with their partners is as important for their supply chains as the economic relationship.

How important are the following areas for your companies performance in todays economic environment?



In summary, to best prepare your firm's supply chain to both survive a recession and emerge strong after it, focus on the following five characteristics:

- Active commitment to supply chain partners, visibly flowing down from senior levels of the organisation,
- more effective control through increased information sharing rather than less,
- an unwavering (daily) focus on all aspects of contingency planning,
- recognition of the importance of developing trusting relationships (ethics) as opposed to a focus on transactional legal/economic contracts
- and an ability to foster deeper collaboration with supply chain partners.

References

1. Duncan M.L. Scholtz, 'Lucent SCN: Leveraging the fully integrated supply chain', MIT, June 2004
2. David Blanchard, 'Supply Chain Management – Best Practices', John Wiley & Sons, 2007

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For further information or a company briefing on this report please contact us at info@obaconsulting.com