

# Creating Competitive Advantage with your Supply Chain to Thrive the Economic Earthquake

## *Think Twice before Hacking your Organization to Pieces*

by Robert Porter Lynch

Make no mistake -- this Economic Earthquake is a monster and its after-shocks will resonate for the next 3-5 years. Like a deadly cancer, in just a few months it has successfully infested every marketplace around the globe with dreadful results. Unless business takes carefully designed steps both strategically and operationally, the results could be your business's demise.

Action needs to be taken quickly before time and cash runs out. The banks don't seem to be able to help when you need cash the most. And worse, they are lopping off lines of credit, making it nearly impossible to finance new growth.

### **How should you proceed in a world where the old rules no longer apply?**

Your first instinct may be to hack and slash costs. While this is important, it's not the first place to start. A company cannot cost-cut its way to prosperity.

### **First, Think Strategically:**

#### Beware of Cost Advantages:

As the initial step, you must think about the direction you're headed -- what is the competitive advantage you really have? If it's just price, that probably will not be good enough, because every sinking competitor will cut its prices to survive, catching you potentially in a death-spiral of endless cost-cutting. Squeezing suppliers who are undercapitalized and strapped for cash will probably be counter-productive and may just drive them out of business. This type of war of attrition is likely to be a blood-bath of red ink for everyone who engages. A strategic focus on competitive advantage and value creation is, in the longer view, more important. Innovation is a more powerful advantage than low cost.

#### Supply Chain as a Strategic Asset:

If your outside purchases are more than 40% of your total corporate budget, then your supply chain is a strategic asset, but most probably it's not been used to create a real competitive advantage, although it should be. The best companies, like Toyota and Honda, collaborate with their suppliers to create massive advantage by focusing on innovations, including those that will lower the cost of flowing products and services efficiently throughout the entire supply chain.

## **Second, Focus on Your Customers:**

### Keeping your Customer Competitive:

New economic realities demand dramatically different thinking from the past. This time around you've got to think about how to keep your customer alive, too. If your customer is not healthy, you will inherit the malady! More businesses fail for lack of sales and strategic positioning than other reasons. Remember the top-line: REVENUES; it's the only line on your operating statement that makes a positive contribution to profit.

Understand the Customer's Value Needs: But don't start with what you want to "sell" to a customer. Instead, set up a meeting with your top ten or twenty customers. Then explain to them you are seeking ways in which to create competitive advantage for them. The objective is to make your customer more successful by: offering them new innovations that will help them thrive and beat their competition, thus increasing their revenues and profits, which, in turn increases your revenues. Seldom will the customer's procurement people know the answers to these questions; you'll probably need to speak directly to senior management.

## **Third, Concentrate on Value & Innovation Flows**

### Engage your Chief Supply Chain Officer:

Your key supply professional should be an integral part of the customer discussions – they need to know what creates competitive advantage for your best customers so that innovations from key suppliers can flow through to key customers. Cash flows in the opposite direction and in direct response to value and innovation flows. If you want to generate cash, find ways to create value and useable innovation. Be sure to learn what the customer truly values and what innovations will create competitive advantage.

**Innovation is the single most important competitive advantage  
in a fast-moving, rapidly changing world.**

### Innovation from Suppliers:

Some of the most important innovations are simply "process" innovations that eliminate non-value added and cut time and cost, without eroding the profit margins of suppliers. (Toyota and Honda are experts at this.) However these are often the most difficult to identify and replicate because they look invisible. In the larger view, the most competitive companies at the end of the chain are those that have lined up a series of best-in-class companies contributing to the end product/service. In other words, this is a *battle of value chains*. Thus, thinking of your suppliers strategically and getting your customers to treat you strategically in the creation of value is a powerful weapon in the competitive battle.

### Innovation Isn't Just technical:

When you think of innovation, don't get stuck thinking strictly of *technical inventions* -- this is just one of the types of innovations you can use to create value. Other approaches include joining a series of products and services together into an integrated *solution cluster*, much like OnStar does. Another approach is to make *improvements and integrate* new features into an existing product, much like the iPod. Still another is to make *process flow* improvements, using such methods as lean management. But there are still more ways: you can *extend your existing customer base* by selling them new products and services, perhaps through an alliance with a company that does not share your customers. Or you can create a *new business model* to create competitive advantage in a new way, such as selling on the internet or providing new services that will ease your customer's problems.

### **Fourth, Beware of Outmoded Metrics and Rewards:**

#### Power of Metrics:

Whatever you measure drives people's daily behaviors. Measure cost cutting, and you get cost cutting. Measure and reward old approaches, and you get old behavior. Implement a new program, but don't change the reward system, and people will behave dysfunctionally.

#### Linking the Value Chain Requires Different Cost Metrics:

Most companies measure costs using old-fashioned cost accounting designed centuries ago to measure unit costs -- such as hourly labor costs, purchasing costs, etc. Often this metric can be highly deceiving because it masks all the other costs involved in production. It is much better, particularly for critical products and services to use a Total Systems Cost (or Total Cost of Ownership) approach. This means looking at:

- **Product Design**
  - Parts Reduction, Design for Manufacturing & Assembly, Integration
- **Requirements Definition**
  - Specs, what we need, when we need it, where we need it
- **Forecasting Accuracy** (often 5-15% of TCO)
  - Inaccurate forecasting increases cost of manufacturing & inventory control
- **Source Identification**
  - sources, selection of sources
- **Acquisition Costs** (typically this is only 25-40% of TCO)
  - requisitioning, purchases, delivery, receipt, payment
- **Processing, Storage & Inventory**
  - inventory, staging, reclamation, reconditioning, supply warehousing, preservation
- **Operations, Conversion, Installation, & Maintenance**
  - operational costs, maintenance, repairs, testing, labor, training, integration, assembly
- **Quality, Breakdown, Downtime, Scrap & Waste**

- reduction of productivity, cost of scrap, lost time, disposal, re-tooling & re-ramp-up
- **Non-Value Add**
  - Hard-Nosed Negotiations, Missed Communications, Faulty Invoice Processing
- **Risk Mitigation & Legal**
  - Insurance, Unnecessary Legal Filings, Law Suits
- **Transportation**
  - Travel, Insurance, Overtime, Licensing, Packaging, Record Keeping
- **Warranty & Service**
  - costs of repairs, brand name degradation
- **Impact on Sales**
  - lost sales, slow time to market, failure to be able to deliver orders
- **Retirement & Environment**
  - resale, salvage, disposal, & waste management
- **Future Strategic Positioning**
  - new research, innovation, competitive advantage, ancillary benefits

#### Measure and Reward Innovation:

The other most important thing to measure is *ideas that are translated into useful improvements*. Japanese companies typically receive at least 8 good ideas per person annually with over an 80% implementation rate, resulting in massive improvements cumulatively over the years. However, American companies are notoriously bad at this, receiving only 1 idea for every 12 people, and implementing less than half the suggestions. Similarly, suppliers are also a great source of innovative ideas, but most companies see them as merely “vendors” and not a source of competitive advantage. Thus suppliers are all-too-often treated poorly and pounded upon for price-cuts, not value increases.

#### **Fifth, Build a System of Trust & Teamwork:**

##### Trust is the Foundation of Teamwork & Innovation:

Great leaders understand that ... **Trust unleashes and focuses the latent human energy in an organization, resulting in enormous productivity and innovation.** Internal teams function to keep your organization alive. Alliances with customers, other providers, and suppliers are the external teams that can radically improve your prospects for success.

##### Trust is a Competitive Advantage:

Our initial research is indicating that there is up to a 50% competitive advantage for companies that have high trust with their suppliers and customers, as opposed to those with deep distrust. This is a massive advantage that’s too often overlooked in companies. It is a terrible cost of doing business that is, for all intents and purposes, hidden from view -- it never gets reported on the balance sheet or P&L, because, like a poison, it’s imbedded in every line item. Every leader at every level of the organization should be attuned to creating trust, because it costs far less to have trust than the alternative -- nagging, gnawing distrust that daily pilfers people’s energies and

creativity. Yet most leaders tell us that their relationships in business are filled with manipulation, deceit, criticism, extraneous legal protections, posturing, skimming, hidden agendas, and subtle trickery that damages good decision-making, slows down communications flows, and blocks creativity and innovation.

**Trust determines the destinies of people and the course of nations**  
-- Paul R. Lawrence, Professor Emeritus, Harvard Business School

## Conclusion

Before you hack, slice, dice, and dissect your organization, think twice, and be sure you're doing the right things for the right reasons. Conventional thinking may say "cut," but these aren't conventional conditions. Every problem has an opportunity. Every one of your customers is seeking a solution, and you might just be the one to have it (or part of it).

Because sales revenues are essential in these tough times, keeping your customer in business is a new job you might not have thought of doing before, but is a massive advantage to those who have the vision, fortitude, trust, and innovative spirit.

### Things to Remember

- **You Cannot Cost-Cut your way to Prosperity**
- **In a Fast Moving World, Innovation is the most sustainable source of competitive advantage**
- **Innovation from Suppliers is typically the least costly, least risky, and often the fastest to market**
- **Strategic Suppliers are an Untapped Wellspring of Innovation, but require a new form of Strategic Relationship to access it**