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ON THE TABLE

Total Value
Optimization



The Transformation of
Supply Chain Management

From Cost Containment to
Strategic Value Creation

Organizations are evolving their view about the criticality of supply chains in managing their global competitiveness and risk exposure. A range of factors are increasingly reshaping supply chain strategy: From high capital requirements, lagging utilization rates, and expanding global distribution networks to capacity shortfalls, inadequate responses to product demand, infrastructure limitations, and security concerns.

For most industries, the rules of engagement have been shifting; in some instances, dramatically. New pressures to better manage the value stream are requiring more stringent supply chain standards and the leveraging of stakeholder value creation. Company leaders are more challenged than ever to embed practices that improve growth prospects and profitability performance while at the same time drive long-term competitive agility, resiliency, and risk management.



Synchronization of all global enterprise functionality (i.e., manufacturing and distribution, procurement, sales and market

A complex network diagram with a central node and many peripheral nodes, all containing various business and technology icons like charts, checkmarks, and a thumbs up. The nodes are interconnected by a web of dotted lines, suggesting a global or interconnected system. The icons include line graphs, bar charts, checkmarks, a thumbs up, a puzzle piece, a globe, a document with a checkmark, and a speech bubble. The overall theme is business success, growth, and interconnectedness.

A cross today's multidimensional landscape, component or raw material access, production, distribution, and manufacturing integration can be greatly impacted by any number of scenarios that may induce a ripple effect across the supply chain. A wider range of corporate stakeholders, more distantly connected to the source of any disruption, may become dramatically impacted overnight. Lack of control and uncertainty can feed a context in which business stability or continuity becomes threatened.

development, finance, and IT) is essential for anticipating the uncertainty that is part of this new supply chain environment.

A unique role for the procurement executive is emerging as orchestrator of a new collaborative approach that delivers exceptional value to the contracting company – and its supply partners. At no time in history has such an opportunity for a different leadership model and methodology been possible. Procurement is becoming a central strategic asset that can determine the immediate and long-term financial performance of a company.



Moving Beyond the Historic Orientation on Controlling Costs

For decades, contracting companies tended to rely upon a fairly simplistic, price-based model of procurement. Purchases were straightforward transactions driven by internal requirements; buyers placed a high priority on the 'errand' of securing the lowest purchase price.

Over the past two decades, price-oriented decision processes have been superseded by the Total Cost of Ownership (TCO) model, whereby companies analyze multiple direct and indirect costs associated with purchases. For many companies, TCO led to an important breakthrough. Instead of reflexively buying the least expensive product, the procurement team looked at the total cost of a product over its lifetime – including the hidden costs associated with quality, durability, throughput, and yield. As a more comprehensive view, TCO represented a leap forward but it is proving to be insufficient for meeting the demands placed upon companies today.

The new demands on procurement are based on several factors that include the changed nature of global competition, more complex supply chain operations, new risks from uncontrollable externalities, growing scrutiny around responsible business practices, and greater expectation for delivering tangible value to the end customer.

To ensure that procurement practices are aligned with the organization's key business metrics, procurement professionals must secure their seat at the C-suite table for input on a wider range of strategic discussions. These include issues around value creation for the end customer, sustainability and corporate responsibility, license-to-operate and risk management, new market development as well as network optimization, and marketing and sales. Companies must build a more durable foundation from operational agility and resiliency. By embracing



Supply Chain Strategy as New Value Creation

a more strategic approach to procurement, they can cultivate relationships with suppliers capable of delivering continuous innovation, financially accountable sustainability practices, and tangible value to the end customer. This new imperative encourages open dialogue, team decision-making, and interdependent business

Total Value Optimization empowers procurement professionals to facilitate communications across internal business units and external supply chain interests. By aligning internal business mandates with external supply chain capabilities – and

TVO Priority Check List:

- ▶ Practice procurement strategically – as value creation and optimization
- ▶ Cultivate a value-driven supply base
- ▶ Operationalize your values across the supply network
- ▶ Be ready for new challenges to supply risk mitigation
- ▶ Make organization resiliency a priority
- ▶ Manage the reputational fallout from any supply chain disruptions
- ▶ Respond appropriately, and with discretion, to stakeholder activism
- ▶ Be vigilant about impacts upon shareholder confidence and financial resiliency
- ▶ Be ready for new expectations of quality assurance and new requirements in sourcing safety
- ▶ Respect the “license to operate” norms in overseas or developing markets
- ▶ Expect to navigate increasing political, cultural, and legal dynamics when sourcing in volatile regions

relationships with a high degree of trust. By doing so, forward-operating companies may transition away from many of the historic constraints to a new, differentiated model: **Total Value Optimization, or TVO.**

fostering collaboration between the two entities – companies can achieve more efficient operations, improved productivity, less downtime, increased revenue and, ultimately, better value to the end customer. This forward-operating



strategy takes a holistic view to positively impact the organization's top and bottom line.

TVO requires a significant shift in mindset toward the role of the supplier community: Suppliers are viewed as value providers rather than cost drivers; enablers rather than inhibitors. They function as partners who can respond rapidly and propose innovative solutions to difficult manufacturing, sourcing, logistics, and distribution challenges.

TVO also ensures a positive impact from new value creation for the end customer. This value may come in an array of forms – from greater creativity in, and access to, intellectual property, innovation lifecycle enhancements, and product improvements (such as extended longevity and utilization) to faster speeds to market, incremental gains in mindshare, and easier access to under-utilized supplier community resources that can benefit both the company and the customer.

This new world of TVO embraces the old procurement world in its vision: Companies still need an array of suppliers that can complete the basics well, provide a product when and where it is needed, with the right quality. However, there is also a subset of potential 'super suppliers' that could be segmented for thinking and acting differently. That segment can become the next-generation innovators that produce insights into how a company may differentiate its supply chain operations to create a top and bottom-line impact. By nurturing and inspiring those suppliers through a shared commitment to improvement, everyone's game is elevated to a new level.

From a macro perspective, TVO encourages forward-operating companies to evaluate their overall footprint to understand holistically – from their suppliers' suppliers through to their customers' customers – what they can be doing differently. By taking a holistic view of where they are positioned in the broader ecosystem, they learn how to generate more value. It requires a

different way of measuring success – necessitating a commitment by the leadership to change the organization's culture around how internal and external stakeholders work together, how problems are approached, and the manner in which opportunities are pursued.

TVO may also incorporate the emerging priorities within sustainability and corporate responsibility, which correspondingly require stronger relational ties between companies and the communities in which they depend upon for business operations.

Eric Lowitt, a leading Sustainability Strategy Advisor and author of *The Future of Value* (2011) and *The Collaboration Economy* (2013) points out: "Companies are being held accountable by influential stakeholders and powerful institutional clients for the environmental and social

Implementing a TVO Procurement Strategy

impacts of their value chain business activities. Reducing suppliers' environmental and social impacts is akin to developing a competitive advantage for these companies, and procurement is the central function involved in this process.

"One example of how this extends to local communities," says Lowitt, "is with oil and gas companies developing reservoirs in local areas. They are beholden to those jurisdictions and the willingness of its citizens to allow them to explore and produce, to draw off their infrastructure, and to conduct a range of operations in the immediate area. The most far-sighted oil and gas companies are seeking partnerships with community leaders, engaging regularly through such devices as stakeholder town meetings, to yield collaborations with the local community in order to deepen trust between the two." Lowitt points out that the same process is playing out in the chemical, mining, and food and beverage sectors – industries that depend upon large production installations in locales where they often become a dominant economic force.

The TVO methodology pushes beyond conventional boundaries to help companies build an essential trust and risk management orientation – supporting focused and aligned interactions that can lead to improved profitability, increased cash flow, reduced risk, and a more loyal customer base.

There are numerous factors involved in the implementation of a Total Value Optimization approach to procurement strategy:

1. Enterprise-Wide Metrics to Drive Collaboration and Bridge Silos

It is critical for discrete business units within an organization to be aligned in terms of metrics and accountability. The old adage is often true: What gets measured gets done.

Unfortunately, individual lines of business often have differing, or even conflicting, metrics to guide their processes and assess performance. Instituting uniform metrics that are relevant, and that can accommodate the variances in functional capability and output between units, can bridge the reflexive mode of operating in silos.



Acting out collaboration across silos can be achieved through a process known as ORCI (Owner, Responsible, Consulted, Informed).

- **Owner:** Every project has an owner who functions as the primary steward of collaboration; someone who allows cross-functional teams to voice their unique viewpoints and bring new ideas to the table.
- **Responsible:** The project owner subjects all new ideas to careful analysis to ensure that all options have been explored – including sufficient integration of any resources suppliers may offer. Suppliers are then empowered to support the organization's drive for innovation. New ideas are feasible from a business perspective because they align with key metrics.
- **Consulted:** The project owner proposes procurement solutions only after a mandatory consult with internal cross-functional teams and external partners. This consultation focuses from the holistic view of how to drive innovation and optimize value for the end customer.
- **Informed:** Once a decision has been made, all units are informed so they can understand the thinking that led to the final decision.

With the implementation of enterprise-wide metrics, individual business units are better enabled to focus and align with the company's key performance indicators – a critical factor in avoiding reliance on purchase price in a more complex ecosystem. With TVO, sound procurement decisions must also consider product quality, yield, throughput, customer demand, logistics, maintenance costs, inventory management, disposal practices, environmental impacts, sustainability implications, company brand management, and more. The short-term impact of any procurement decision must be weighed against the multiple forces that determine the long-term value of each purchase for the business as a whole.

Here are some questions company leaders should be asking of themselves and their colleagues:




What can we do to evolve our company's culture to one of true collaboration – leading to development of high-performance teams?

What governance frameworks need to be established to allow conflict to be uncovered and resolved as appropriate?

What metrics and incentives would help promote holistic thinking?



Evolution of Strategic Supply Chain Management

	Success measures	Communication	Supply base	Accountability	Reactive vs. proactive	Relationships
Next Generation: Total Value Optimization						
	Balanced view; focused on value created, company-wide metrics, risk, revenue, strong innovation, sustainability 18-25% Improvement	More integrated among multiple internal-external stakeholders	Optimized to strategically aligned suppliers that deliver best value	Cross-functional teams with commercial representation manage relationships and outputs	Strategic planning and execution to drive cost/value relationship	Cross-value chain relationships evolve to ongoing innovation, risk mitigation, sustainability, and revenue implications
Second Generation: Total Cost of Ownership						
	Cost oriented view; focused on price, quality, durability, market savings, total cost savings 8-12% Improvement	Based on reduction of raw materials, logistics, and production costs	Built on optimal value stream providers that meet specification	Supply chain manages relationships and outputs	Proactive analysis of value stream options	Cross-functional relationships oriented to year-on-year or contract cycle and cost management
First Generation: Price-Based						
	Price focused view; reduction in purchase price is paramount 2-4% Improvement	Minimal supplier interaction beyond pricing and specification	Supply base built on ability to meet specifications and provide lowest price	Procurement manages relationships and outputs	Reactive to internal requirements	Transaction-based relationships

How can we engage our suppliers

in dialog to inspire their support of our innovation and continuous improvement?

How do we cultivate the development of a supply base whose values align with ours – especially in corporate, environmental, and social responsibility?

How do we ensure that our suppliers proactively manage total quality standards for their raw materials as well as those of their own suppliers throughout the value stream?

How can we leverage the supply network's capabilities to drive the maximum value for our company?

How do we establish agreements that explicitly define expectations for all parties?

What steps can we take now to personally transition our organization to where we are seen as a driver of value versus a manager of costs?

2. Suppliers as Partners: Cultivating Truly Collaborative Relationships

Most companies rank driving innovation as extremely high on their list of priorities. When organizations view suppliers merely as vendors, the relationship offers little more than a series of financial transactions. However, when suppliers are given the opportunity to grow into strategic partners, they can propose and help facilitate innovative solutions to emerging challenges.

Simon Croom, Ph.D., Professor of Supply Chain Management at the Supply Chain Management Institute of the University of San Diego, has researched the role of trust in building meaningful partnerships with suppliers. Croom is convinced that, "When you have high trust-based relationships, you get far greater levels of business performance that is demonstrated by improved profitability, efficiency, effectiveness, cost savings, and innovation. Trust can provide a significant competitive advantage for businesses, enabling closely knit teams to become more entrepreneurial even within a highly-structured environment – responding rapidly and thinking creatively with minimal conflict and reduced risk. Companies need employees and suppliers who can solve procurement problems

through innovation – whether by redesigning products, streamlining processes, optimizing logistics, or reducing waste."

Case in Point: Eastman Chemical Company's Vision for Change

In recent years, Eastman Chemical Company has transformed itself from a commodity-based to a specialty chemical company, re-orientating their procurement team from price/volume negotiations with suppliers toward strategic collaboration. The company now evaluates suppliers on their innovation and creative insights within an open, collaborative process that allows everyone to succeed as a team. Eastman's leadership recognized that such a fundamental change would require a cultural shift. To that end, the entire procurement organization has received substantial training on business development issues – including methods for collaboration, social styles, and sales and marketing effectiveness. Eastman CPO





3. Sustainability as a Tool for Innovation

Mike Berry explains: "Once your procurement team moves beyond blocking and tackling on price/volume, they can provide market insights, build internal consensus, collaborate with suppliers, and respond to business challenges with innovative strategies.

"We totally changed our scorecard for suppliers. As we rate our suppliers and sit down with them to explain what's important to us, it is much more skewed toward innovation, technology connects, working together to achieve breakthroughs – as opposed to the traditional measures of price, payment terms, on-time delivery, or conformity to specification."

Berry is convinced that by cultivating strategic relationships with suppliers, you can expect to achieve more innovative solutions to new and existing business challenges, gain a more comprehensive understanding of your supply chain strengths and weaknesses, reduce a myriad of risks, and create an improved experience for the end customer. "In forging these new partnerships, procurement professionals should perform due diligence that includes requiring new and existing suppliers to meet certain performance standards."

Conserving water, reducing the carbon footprint, eliminating waste, and ensuring fair labor practices are among a host of issues that are important to building enduring stakeholder relationships for organizations – whether with consumers, investors, employees, local communities, or other businesses.

"Social responsibility and environmental sustainability are top issues for major organizations now," says Simon Croom, "and the supply chain is where sustainability really hits. It is the dominant competitive criteria of our age – and it is going to become even more so, whether because of regulatory pressure, reputational threats, or organizational will."

At every stage in the innovation of a new or existing product, opportunities exist to reduce its environmental impact or enhance the social value. The TVO framework better enables collaboration so that companies can move toward enabling products, materials, and components to become more sustainable. By partnering with suppliers that recognize where waste is created, and by weeding out weak suppliers, companies can reconfigure for improved profitability and ROI.

Mike Berry offers a case in point:

"We were manufacturing a molten product in Europe, putting it in a tank to cool it off, and then shipping it by truck to a customer as a solid form where they then heated it back up. That whole lifecycle didn't make a lot of sense. To reduce our footprint, we collaborated with our supplier to build a different model. Now the product remains in the molten form the entire time, with no need for cooling or reheating. We shared the cost of that transformation and as we became more efficient at it, we both saved money."

Suppliers that prioritize value generation tend to naturally promote innovation; therefore they can reduce the inherent risks that are prevalent across today's complex geographic, political, cultural, and economic supply terrain. For example, sustainability-centric suppliers may reduce

risk simply by not operating in unstable regions where unfair labor practices, corruption, or human rights violations pose a potential for disruptions and negative reputational impact.

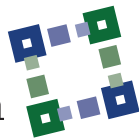
A core benefit of TVO is accountability, which in turn ensures visibility between contracting organizations and

their suppliers. Such visibility is critical for tracing supply back to raw materials to identify pockets of potential liability – and for eliminating suppliers that introduce unacceptable risks that may ricochet throughout a network. **MP**

Strategic Procurement: Today's Evolved Context

- ▶ **Sharper Focus...**
...on impact and risks outside of the traditional cost containment and improvement efforts.
- ▶ **Greater Awareness...**
...of stakeholder attention on Sustainability and other responsible business practices.
- ▶ **Better Clarity Amidst Complexity...**
...bringing greater opportunity in a globalized economy.
- ▶ **Enhanced Visibility...**
...across the supply chain and value stream, making awareness a tool for achieving better results.
- ▶ **Transparency...**
...clearing a path for supplier innovation and resourcefulness, engendering collaboration with sourcing clients and benefitting the end customer.

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