CFOs AND THE SUPPLY CHAIN

A report prepared by CFO Research Services in cooperation with UPS Consulting

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ABOUT THIS REPORT

In April 2003, CFO Research Services (a unit of CFO Publishing Corp.) launched a research program to examine the CFO's perspective on supply chain management. This report summarizes the findings of a mail survey of 247 senior financial executives and telephone interviews with 15 more. UPS Consulting, a global supply chain management consulting service, funded the research and the publication of our findings.

In addition to our survey respondents, the following companies participated in our telephone interview program:

- Arrow Electronics
- AmerisourceBergen
- Boehringer Ingelheim
- DTE Energy
- Heineken U.S.A.
- Herman Miller
- Hewlett-Packard
- ICI Paints
- Industrial Distribution Group
- Labatt U.S.A.
- Lear Corporation
- UnitedHealth Care

CFO Research Services and UPS Consulting developed the hypotheses for this research jointly. CFO Research Services produced the final report. We would like to thank Todd Wandtke at UPS Consulting for his guidance and support.

At CFO Research Services, Bennett Voyles conducted the interviews and wrote the report. Don Durfee oversaw the project and edited the final report.

Finally, we would like to thank the many executives who participated in our study. Without their contribution, this report would not have been possible.

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Study methodology

In the spring of 2003, CFO Research Services conducted a written survey of U.S. CFOs and other finance executives to learn more about how they view supply chain management and how their role in the supply chain is changing.

Our mailing yielded 247 responses. Fifty percent are CFOs or senior vice presidents of finance, 15 percent are controllers, 17 percent are vice presidents of finance, and 13 percent are directors of finance. The remaining five percent comprise various titles, including finance manager.

We focused our mailing on three sectors:

- Retail/Consumer products (31 percent)
- Manufacturing (26 percent)
- Health care (26 percent)

The remaining 17 percent of companies are from a range of industries, including professional services, chemicals, energy, and financial services.

The respondents comprise a broad distribution of mid-sized to large companies:

- Thirty-seven percent of respondents work for companies with $1 billion or more in annual revenue
- Thirty-three percent have $250-$999 million
- Twenty-nine percent have $100-249 million

To provide a context for the quantitative findings, we also conducted interviews with 15 senior executives at 12 companies (see "About this report" for a listing).

Chapter 1

INTRODUCTION

"To stay competitive, we need to make sure that we are best-in-class in terms of supply chain cost structure."

- Senior executive of a manufacturing firm

As global competition continues to intensify, more and more companies are competing primarily on the nimbleness of their supply chains. Lean supply management, the growth of outsourcing, and the rise of make-to-order manufacturing have made supply chain management an increasingly critical element in creating and preserving value.

Yet in this world where the best companies have transformed themselves into the corporate equivalent of Formula One racers, and have taught their vendors to function like a tightly knit pit crew, many CFOs say that their companies still act as if the speed limit on productivity were 55. Many of the 247 top financial executives who responded to a recent survey undertaken by CFO Research Services seem highly skeptical of their firm's competence in supply chain management. In this study, we found that a majority of CFOs say that their supply chain leadership is still decentralized, that their company's supply chain is poorly aligned with corporate strategy, and that obtaining a clear picture of a company's total costs and sources of value remains difficult.

Without fundamental changes in the way the supply chain is managed, the end for slower companies seems all too easy to predict: either watch swifter competitors race past or, more dangerously, try to compete despite the antique engine.

Although transforming the firm to perform at this new velocity is very much a team effort, the CFO appears to have a special role to play. As one of the few senior executives with a detailed understanding of a company's inner workings and sources of value, but who has no vested interest in current modes of supply and distribution (unlike sales and operations, for instance), the CFO seems a natural candidate to help drive that change.

The rising importance of the CFO in supply chain management is already underway. In many leading companies, such as The Home Depot, Sun Microsystems, and Delta Air Lines, the CFO is in charge of the supply chain. Our survey found that while 34 percent of respondents say they now play either an important or a leadership role in supply chain decisions, 49 percent anticipate playing such a role in two years (see Figure 1, next page).

This study identifies what CFOs in some of the world's largest companies see as the key supply chain challenges facing their organization. It also looks at the ways in which some leading CFOs are using their unique role and perspective to help overcome those obstacles and promote greater distribution and purchasing efficiencies.

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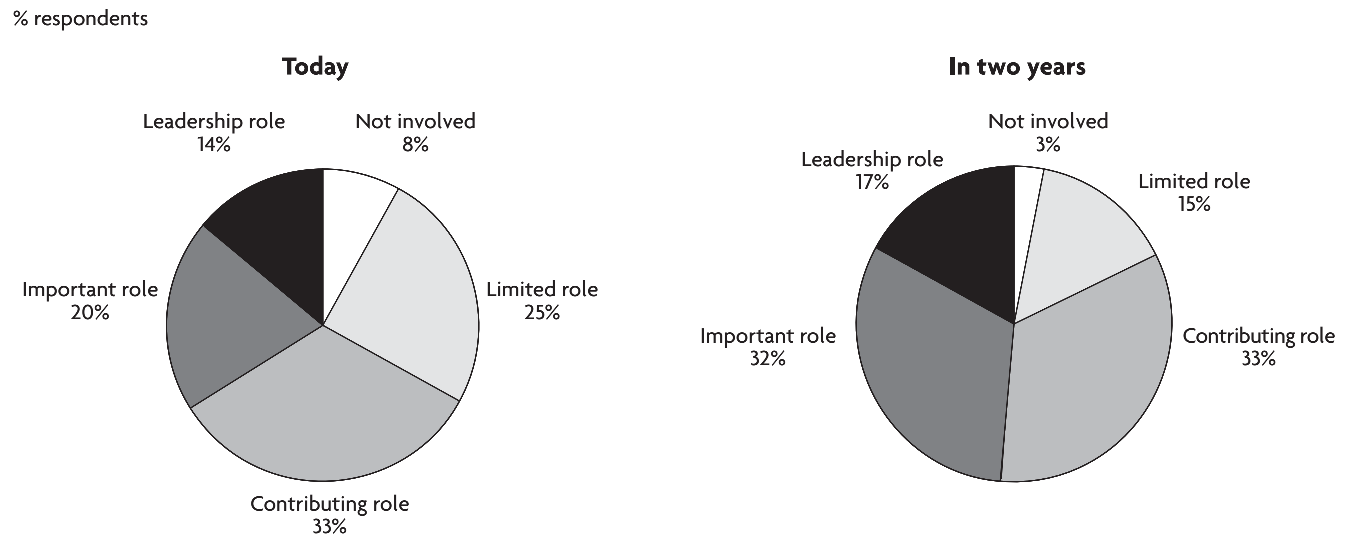
Figure 1: How involved are you in making supply chain decisions?



Source: CFO Research Services

The remainder of this chapter reviews the study's key findings. Chapter 2 shows how CFOs view the current condition of their supply chain and looks at their agenda for the future. Finally, Chapter 3 illustrates how some CFOs are participating in the effort to transform the supply chain, and suggests five ways in which CFOs can help bring about such a successful—and increasingly essential—change within their own organizations.

Key findings

Our survey and interviews have yielded the following conclusions:

- **CFOs see the supply chain as crucial to business success.** Sixty-one percent of CFOs surveyed view the supply chain as having a large or very important effect on their ability to achieve corporate objectives.

- **Operational plans are not well integrated with strategy.** Despite the important role they see for their supply chain, only 33 percent of CFOs say that operational plans (including supply chain plans) are well integrated with strategy.

- **There is a gap between the importance of the supply chain and its performance.** In many different areas, CFOs reported that the supply chain processes they deem important are not being managed well. For example, 74 percent consider supplier management to be very important, but only 50 percent report that their companies do it very well.

- **Supply control is fragmented.** CFOs are dissatisfied with the traditional decentralized approach to managing supply. Thirty-six percent cite supply chain processes not being managed in one place as a problem. At the same time, 34 percent say that their company has unclear lines of authority when it comes to supply chain management.

- **Top objectives are cost control and customer service.** Ninety-three percent of CFOs report that reducing operating costs is a key goal of their supply chain. Improving customer service is the second most frequently reported objective, with 82 percent identifying this as a goal.

- **Companies have difficulty making supply chain changes.** Despite the importance of the supply chain, only a third (32 percent) of financial executives polled said their company could make major supply chain changes when necessary. Nearly two-thirds said they were able to make incremental changes only.

- **CFOs expect to take a growing role in supply chain management.** Today, 34 percent of CFOs report taking an important or leadership role in their supply chain management. In two years, 49 percent of CFOs surveyed believe they will be playing such a role.

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Chapter 2

THE CFO'S VIEW OF THE SUPPLY CHAIN

"I don't just see dollar signs; I see the supply chain as a strategic asset and something that can really be used to drive our business forward."

- Graham Staley, CFO, Labatt U.S.A.

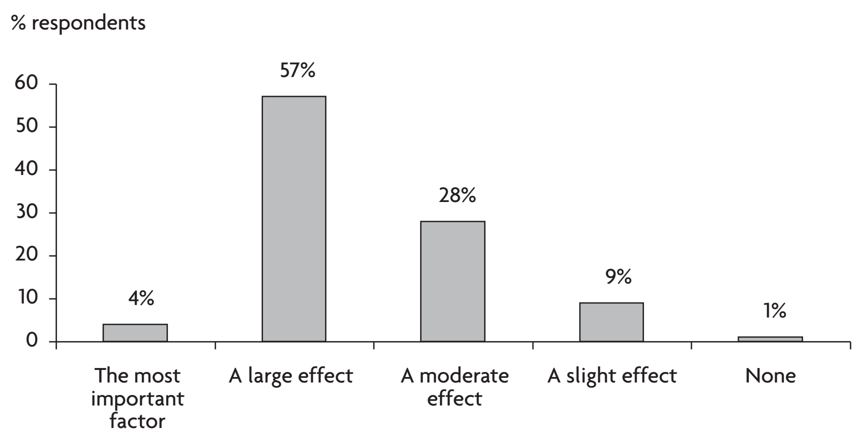
Main points

- CFOs believe supply chain management is central to their organization's strategic goals.
- Many financial executives see major problems with their firm's current supply chain management.
- Top supply chain objectives include reducing operating costs and improving customer service.
- Achieving supply chain objectives will require major changes to the supply chain, but few believe major change is possible.

The CFO is often seen as the devil's advocate of the executive suite—long on questions and short on vision. Yet in the case of supply chain management, financial executives seem to be playing against the stereotype. When it comes to the logistics, distribution, and purchasing practices that comprise the supply chain, finance executives appear to recognize the long-term impact these activities have on a company's financial goals.

In fact, many of the CFOs who responded to our survey acknowledge a direct link between the supply chain and corporate strategy. As Figure 2 shows, 61 percent believe that the supply chain is important to their ability to meet corporate objectives. This is especially the case for manufacturing and retail/consumer products companies—74 percent of manufacturers and 68 percent of retail/consumer products companies view the supply chain as important. By contrast, only 50 percent of health care firms do. (For more information on industry variations in the survey responses, see Appendix on page 25.)

Figure 2: How much impact does the supply chain have on your strategic objectives?



Note: Figures do not add up to 100% due to rounding
Source: CFO Research Services

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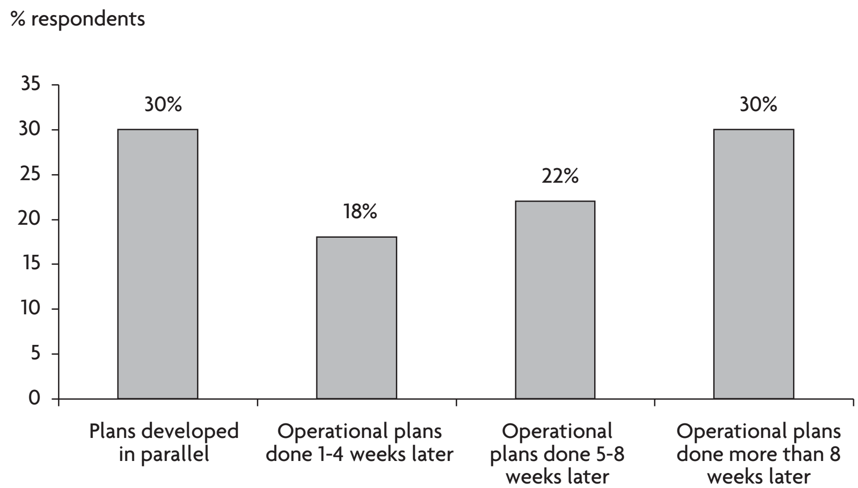
Trouble in the supply chain

Yet there is a problem: only 33 percent of respondents believe that their company's strategic and operational plans are well integrated. Indeed, there is often a large time lag between the development of business strategy and the creation of a supporting operational plan. Approximately half say that their operational plans are formulated at least five weeks after their strategic plans, and 30 percent take more than eight weeks to complete (see Figure 3).

Figure 3: What is the time lag between the development of business strategy and operational plans?



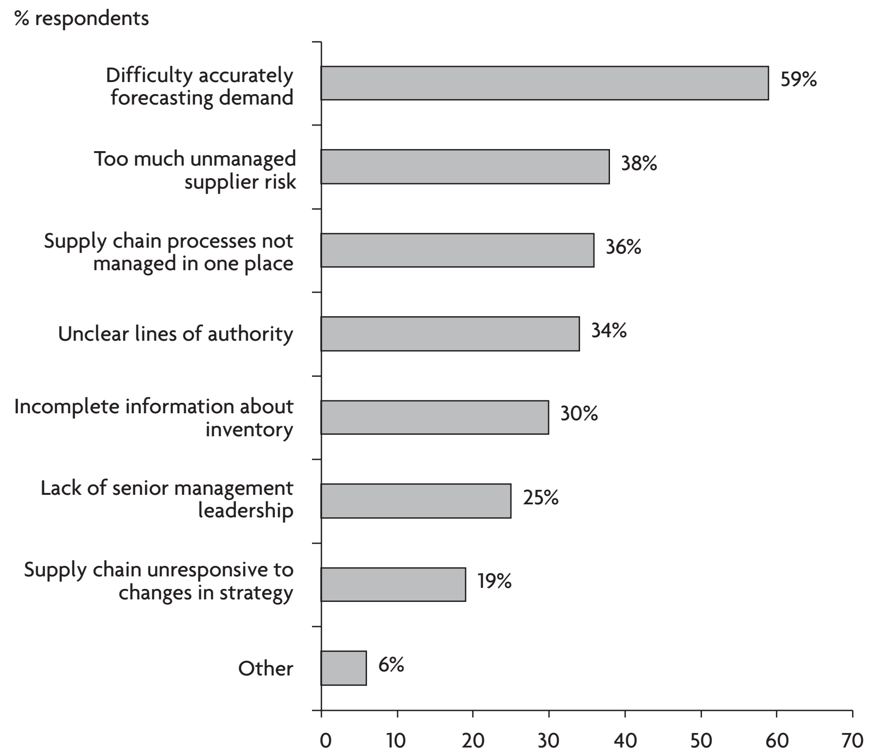
Source: CFO Research Services

Our research suggests that this is at least partly an organizational problem. The supply chain is traditionally managed in many parts of the organization, with no single person clearly in charge. When we asked what problems CFOs see with supply chain management, many cited decentralized management, unclear lines of authority, and a lack of senior management leadership (see Figure 4, next page). When it's unclear who is in charge, aligning the supply chain with strategy is nearly impossible.

Only 17% of respondents are very satisfied with their ability to measure supply chain costs

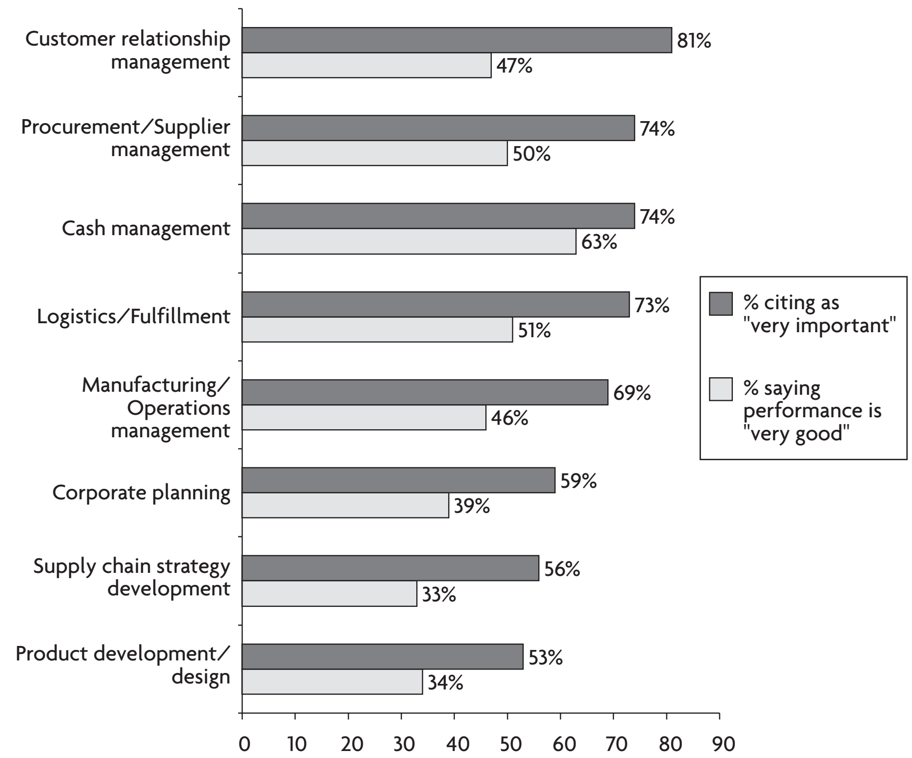
Another product of these organizational problems (in addition to poor strategic alignment) is limited visibility into the financials of the supply chain. Only 17 percent of respondents say they are "very" or "completely satisfied" with their ability to measure total supply chain costs. This lack of transparency extends even to inventory. One of the most important sources of cost savings in supply chain management is paring down inventory. Dell Computer, for instance, the poster child of lean supply management, owes much of its market leadership to the imaginative ways it has reduced the amount of capital tied up in parts and finished products. Yet a third of the CFOs we surveyed cite incomplete information about inventory levels as a difficulty they face. This is in spite of the fact that monitoring inventory levels is the single-most popular metric for assessing supply chain performance among our respondents: 71 percent cite days-on-hand inventory as the number they follow most closely when it comes to monitoring their supply chain.

Figure 4: What problems do you see with supply chain management at your company?



Source: CFO Research Services

Figure 5: There is a gap between process importance and performance



Source: CFO Research Services

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Putting a senior executive in charge of the supply chain appears to improve matters. We found that when the senior supply chain executive reports to the CEO, respondents report a significantly greater satisfaction with their ability to measure total costs.

Our survey also reveals gaps between the importance of supply chain activities and their performance. As Figure 5 (previous page) shows, there are large differences between the number of CFOs who believe processes such as customer relationship management (CRM), procurement/supplier management, and cash management are important, and the number who think they are managed well.

Manufacturers see especially large gaps in CRM and supply chain strategy development—of those that believe these are important, only half say they are managed well. Retail/consumer products CFOs believe their companies fall short in many areas, including CRM, operations management, logistics/ fulfillment, supply, and product development. Health care executives are less concerned, but still see gaps in areas such as CRM, operations management, and corporate planning.

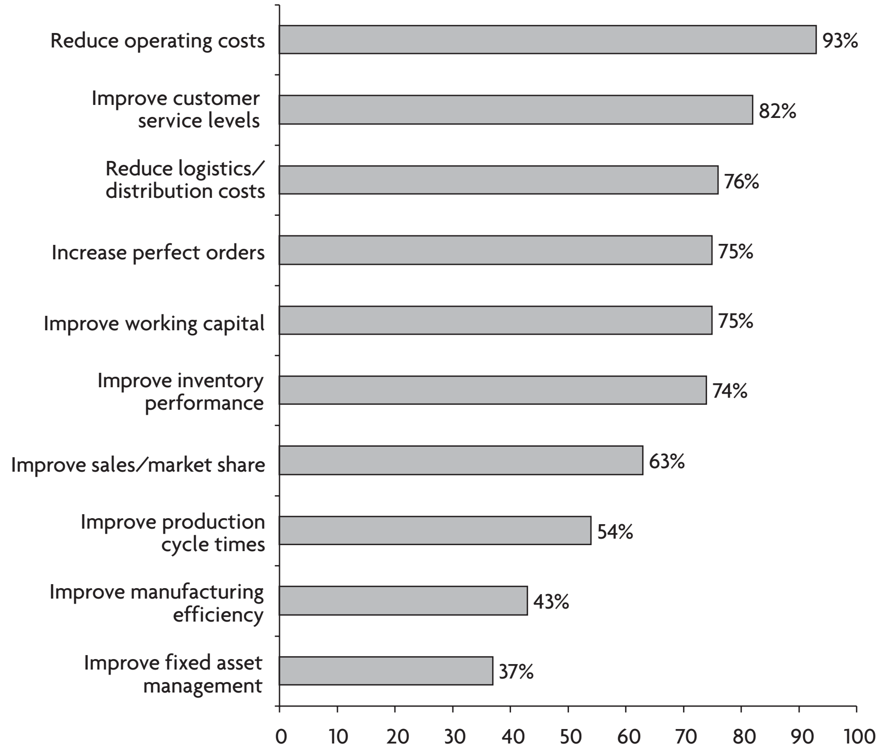
Key objectives

93% of CFOs say that reducing operating costs is a key objective

As gloomy as most CFOs are about current supply chain performance, many consider a number of improvements in the supply chain as essential to their company's future. Cost-cutting is the number one priority. Ninety-three percent say that reducing operating costs is a key objective (see Figure 6).

Figure 6: How important are the following supply chain objectives for your organization?

% responding "very" or "extremely" important



Source: CFO Research Services

More surprisingly, considering the CFO's traditional bias toward cost-cutting, the "soft" objective of improving customer service was seen as the second most important goal (82 percent of respondents). In our supplemental telephone interviews, CFOs stressed this point as well. Graham Staley, CFO of Labatt U.S.A., says that Labatt doesn't look at its supply chain primarily as a place for cost savings. "We're not viewing the supply chain as a cost-saving opportunity as such; we're viewing it as a strategic asset," he says.

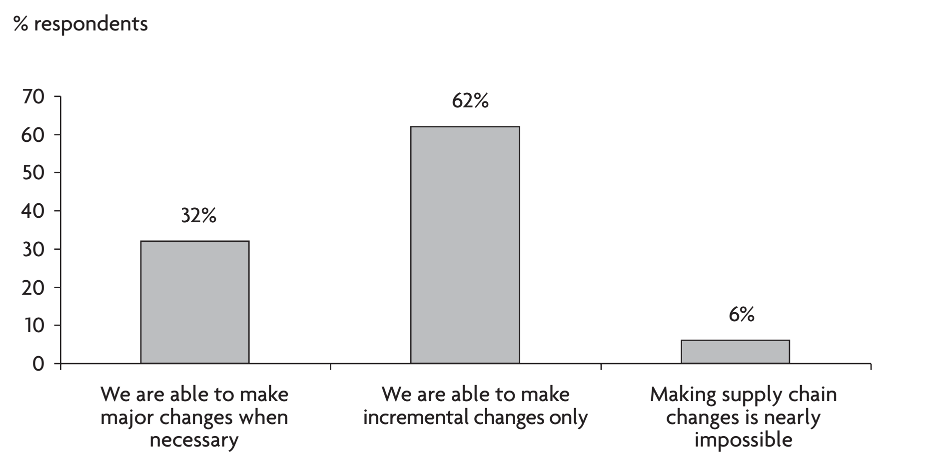
Other concerns fall more squarely in the realm of the back office. Reducing the costs of logistics and distribution was seen as important by 76 percent of respondents. Seventy-five percent want to increase the number of "perfect orders"—that is, orders in which the right product is sent to the right customer at the right place at the right time. Seventy-four percent say improving inventory management was a key objective. And 75 percent hope that they will be able to reduce the need for working capital.

Favored objectives varied somewhat by industry. Retailers are more interested in logistics and sales than other industries, while health care CFOs want to focus more on customer service, operating costs, and logistics. For manufacturers, the top three concerns are operating costs, customer service, and increasing the number of perfect orders.

The difficulty of change

Given the state of supply chain management, achieving these objectives will require deep changes to the supply chain at many companies. Few appear to be up to the task: only 32 percent of respondents report that their companies can make major supply chain changes when necessary (see Figure 7).

Figure 7: What statement best describes your company's ability to make supply chain changes?



Source: CFO Research Services

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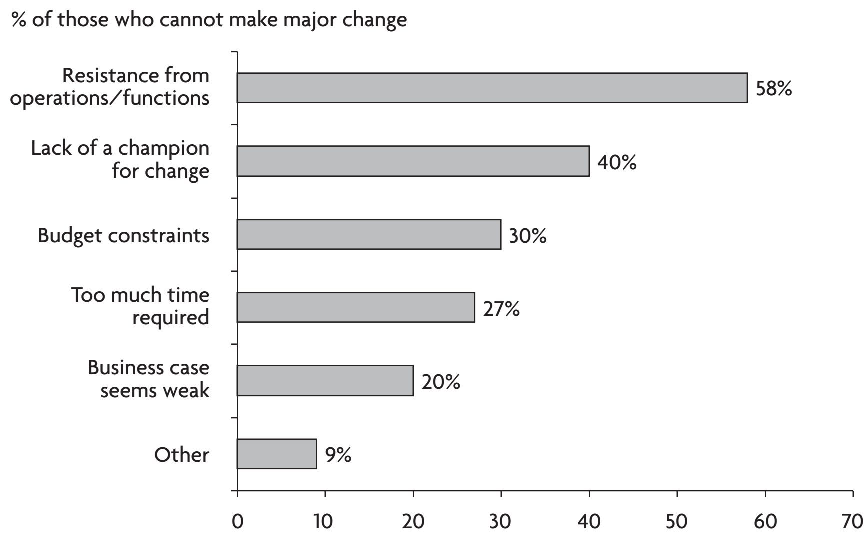
Figure 8: What are the reasons your company can't implement major supply chain changes?



Source: CFO Research Services

CFOs offer a long list of factors that make major changes difficult or impossible, but the top two concern internal politics. Of those not capable of major change, 58 percent give internal resistance from operations or other functions as a major cause, and 40 percent cite lack of internal leadership (see Figure 8).

In our interviews, CFOs say that even something that might appear relatively tractable, such as purchasing patterns, is often very difficult to change in practice. Jack Healey, CFO of Industrial Distribution Group (IDG), an industrial supply company that offers supply outsourcing services to a number of companies, says that the biggest obstacle IDG faces in making those relationships work is curbing what is commonly called “rogue spend”—purchases that plant managers and procurement officers make outside the supply contract.

Often, the purchasing agent or the plant manager has a long-standing relationship with a supplier that they are reluctant to break, Healey says. They may be genuinely concerned about whether the new supplier will come through with an important part on time. Or they may be motivated by not wanting to lose freebies associated with the relationship—annual tickets to a golf championship, for instance.

Regardless of the underlying motivation, transforming the supply chain usually involves a loss of control for these current decision makers, according to Healey. “To convince plant managers and procurement people to give up the control, you need the support of the president of your company,” Healey says. “You need support from the upper echelon to drive it.”

But who in that upper echelon besides the CEO is well positioned to drive such a change? As we will explain in the next chapter, many companies are finding that the CFO is the right person to help transform the supply chain. We will also look at ways some financial executives are helping drive this change.

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Supply chain metrics

When it comes to identifying the best supply chain metric, the ones CFOs follow most closely depend on where the company is now—and where senior management is trying to take it.

Figure 9: What supply chain metrics do you track?

% respondents

Days-on-hand inventory	71%
Operating margin	66%
Total logistics costs per unit	40%
Days payable outstanding	35%
Days sales outstanding	29%
Return on invested capital	28%
Total asset turnover	24%
Return on equity	19%
EVA	14%
Other	11%
Revenue to capital	10%
Fixed asset turnover	0%

Source: CFO Research Services

For instance, Rodolph Italianer, CFO of Heineken U.S.A., says he follows cases sold very closely, as well as inventory levels. He's not alone in having a preference for following inventory numbers: Our survey found that CFOs prefer days-on-hand inventory to all other common metrics (see Figure 9). Seventy-one percent of our respondents say they follow days-on-hand inventory.

David Wajsgras, CFO of Lear Corporation, is one of these. That's perhaps no surprise—Lear, which supplies car seats and car interiors to the world automotive industry, is in a business that Wajsgras says has "razor-thin" margins. "We operate this company as efficiently as many companies say they do," he explains. Wajsgras acknowledges he likes inventory turns because it encompasses overall manufacturing efficiency as well as supply chain efficiency.

Chris Roling, SVP of finance, logistics, and procurement for ICI Paints, says that he watches the cost of working capital, which incorporates most of the areas covered by ICI's sprawling business empire—inventory management, receivables, and payables. In a business that has many factories all over the world drawing from isolated supply lines, working capital gives his team a number that it can clearly focus on even while their underlying supply chains remain scattered.

Of course, there can be danger in concentrating too heavily on one metric. For instance, a CFO who focuses solely on inventory but neglects customer service or lead time metrics may find that efforts to trim inventory result in key customers waiting too long for their orders. According to supply chain experts, it's important to remember that this is a chain, after all—executives need a balanced set of measures to know what is happening at each link.

"Measure, measure, measure," advises Richard G. Dunlop, regional CFO for UnitedHealth Care, "The best decisions are fact-based and come from an objective review and understanding of the business."

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Chapter 3

DRIVING FINANCIAL RESULTS THROUGH THE SUPPLY CHAIN

"If [the supply chain] is the biggest spend area in the company, why wouldn't you be devoting a significant amount of time to it?"

- David Wajsgras, CFO, Lear Corporation

Main points

- For many reasons, the CFO may be a natural leader in supply chain transformation.
- Many CFOs expect to become more involved.
- A growing number of CFOs are already adding significant value to the process.
- Several modes of support seem to be particularly effective.

The results outlined in Chapter 2 suggest that resolving many of the challenges facing the supply chain will require the active engagement of the CFO. As we heard from executives repeatedly in the course of conducting research for this report, CFOs' combination of company-wide perspective and highly developed analytical skills makes them uniquely well positioned and qualified to lead such a transformation.

Unlike other functional areas, such as sales or operations, where directors are often tied personally and politically to traditional ways of doing business, corporate finance has more of an incentive to strengthen the firm as a whole. Like the CEO—and unlike any other top level executive—the CFO is first and foremost a steward for the shareholders. The discipline of their financial training gives them a sound analytical framework with which to assess the impact of system-wide changes. And, as Healey of IDG noted, when setting up outsourcing agreements, accounting and finance jobs are generally not threatened by the layoffs that increased efficiencies sometimes bring.

But should the CFO really assume responsibility for activities such as purchasing, logistics, and distribution? Many are concluding that they should. Among our respondents, 20 percent say that the most senior supply chain professional already reports to the CFO (see Figure 10, next page). At many major companies, including The Home Depot and Delta Air Lines, this is the case. Others are establishing strong links to finance through dual reporting lines. For example, at Lear Corporation, the vice president of finance for global purchasing in the materials management group reports both to the vice president of purchasing and to the CFO, according to David Wajsgras.

Such formal involvement, as well as informal involvement, is likely to become increasingly prevalent over the next few years. As Figure 1 on page 4 showed, a significant number of CFOs believe that their involvement with the management of their supply chain will grow in the near future.

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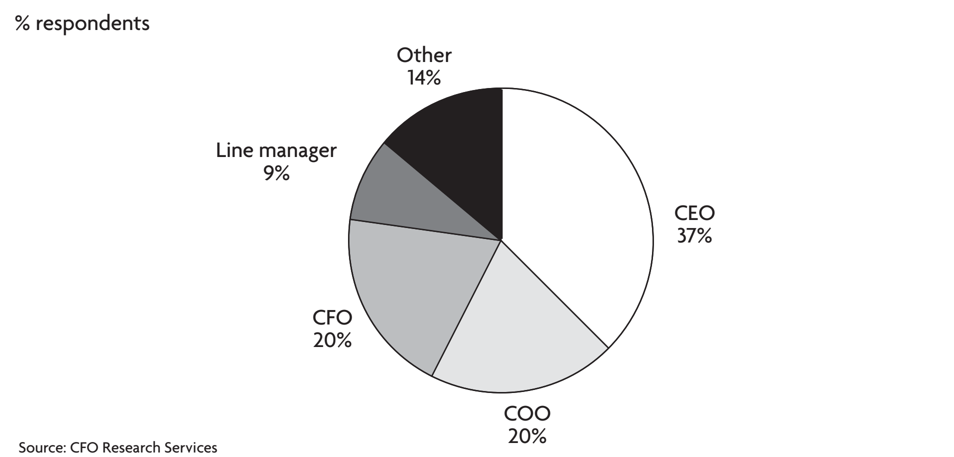
Figure 10: To whom does the most senior supply chain executive report?



Source: CFO Research Services

While such a strong focus on the supply chain might sound like a radical departure for senior financial executives, Wajsgras sees the task largely as an extension of the CFO's traditional role as a business advisor for the company. "It's no different than the way a CFO would support a chief operating officer or the chief executive officer. I think you can provide the same type of objective analysis that we provide when we're looking at what programs we want to bid on, [or] how to improve our manufacturing operations."

In our interviews, we found that CFOs are indeed adding value to their supply chains with these traditional kinds of analytical advice and support. Moreover, some financial executives are also stretching their own roles to fit the needs of today's increasingly complex webs of distribution and supply. Some are acting as champions of new supply chain initiatives. Others are helping to make sales—for example, when there is a need to prove the case for setting up a complex outsourcing partnership. Still others now find themselves in the consulting business, lending expertise to crucial external partners who need financial advice in order to remain both viable and reliable.

The result is closer integration of the finance and the supply chain functions. "When I look at the supply chain," says Paul Reilly, CFO of Arrow Electronics, "whether it's in manufacturing, whether it's in distribution, whether it's on the customer end, I think the financial team plays a very real and vital role in both managing and defining the operation."

In this chapter, we will take a closer look at four areas where CFOs are playing a role in addressing supply chain issues that affect corporate results:

- Reducing operating costs
- Improving working capital management
- Increasing inventory transparency
- Strengthening customer service

Reducing operating costs

Cutting costs is certainly at the top of most CFOs' supply chain agendas, but the executives we interviewed who have successful programs say that there's a right and a wrong way to go about it. In particular, finance executives should be wary of cost-cutting efforts that compromise customer service or the overall value of a product.

Finance executives should be wary of cost-cutting efforts that compromise customer service or the overall value of a product

For instance, many CFOs and their supply chain chiefs describe the reverse auction as one tool with which great care should be taken. "What we have found is that basically it's another negotiating tool, so we're using it judiciously," says Erle Dail, director of supply chain organization at DTE Energy.

Elizabeth Nickels, CFO of Herman Miller, says that the company tries to go through the same valuation process for its supply chain as customers do when deciding to buy Herman Miller furniture. "Herman Miller might not always be the lowest cost provider of furniture, but we think we're the lowest if they look at total cost of ownership, which includes the maintenance factors afterward, the cost to update, the obsolescence and all those kinds of things," she says. "We try to apply those same principles to our own business and our own [supply chain] decision-making."

Drew Schramm, vice president of materials management, credits much of Herman Miller's success with its supply chain to Nickels' ability to take a broader, long-term view. He says that when he showed her that pursuing long-term value with materials and suppliers would cost the firm money in the short run, she still wanted him to stick with his plan to optimize value. "That's unusual," Schramm says, "most CFOs say, 'Yes, that's nice, but I just want the cash.'"

CFOs should also be aware that certain negotiating tactics can backfire. Alain Peracca, the former CFO of Hewlett-Packard's personal computer business segment, offers one example. When Compaq merged with HP and the two companies began to compare pricing information, Compaq buyers—who had a reputation for hard-ball negotiating tactics—found that HP managed to get better prices on some of its parts. The reason: HP agreed to share the risk with vendors of a demand shortfall compared to forecast while Compaq would not, leaving the supplier to assume the cost of any excess inventory. Once they understood the relative risks, suppliers began to offer a lower price to HP and a higher price to Compaq—reflecting the risk that the transaction would not take place. As long as HP was able to forecast within a certain level of accuracy, it left them with a cost advantage.

Profitable cooperation sometimes extends beyond the bargaining table as well. Herman Miller executives say their company will sometimes offer consulting services to suppliers in order to help them improve their processes (see case study, next page). At Lear Corporation, finance plays an important role in similar consultations. The support teams sent out to Tier Two and Tier Three suppliers are led by someone from the finance department. "It's to do nothing more than lend our expertise and help them work out issues they may be facing because of the very difficult pricing and cost environment in which the automotive industry operates," Wajsgras explains.

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Herman Miller's ergonomic supply chain

In the late 90s, Herman Miller's Aeron chair was practically the Official Chair of the New Economy. The company's stylish ergonomic chair and modular office furniture filled offices from coast to coast.

But the design sense of the dotcoms outpaced their business savvy. When the bubble burst, Herman Miller suffered. Even though Herman Miller's make-to-order model shielded it from the kind of inventory indigestion that many manufacturers suffer in a down market, the manufacturer still faced tremendous pressure to cut costs. It did so, trimming six to seven percent from its cost of goods sold annually for the past three years, a total of $120 million in net reductions.

The way the company found these cost savings was not by beating suppliers up on price, nor by compromising its on-time delivery performance. Instead, Herman Miller cut costs in a way that might sound counterintuitive: sending its top suppliers bigger orders.

By concentrating more business with top vendors, and cutting off weak performers, says CFO Beth Nickels, Herman Miller was able to give additional business to its strongest suppliers and gain volume discounts as a result. "Although our industry might be down 40 percent, and our revenues are down 40 percent, our strongest vendors were actually seeing an increase [in volume]," Nickels says. "We're able to get the price reductions without hurting them."

Using a strict numerical grading process, Herman Miller shrank its supply base from 712 companies to 298. As it sorted the stronger providers from the weak, word got out that Herman Miller was getting tougher with its vendors. This yielded an additional benefit—general improvement in supplier performance. "Everybody started to hear that [we were grading our suppliers], and my supplier performance has just been astronomical," says Drew Schramm, VP of materials management. In 1998, he says, the company received about 10,000 errors in every million parts. Today, he says, that's down to 135.

But Herman Miller offers vendors more than business. Nickels says that the company sometimes sends experts to their suppliers who offer advice on how to improve their systems. "A lot of the vendors are smaller in nature and don't have a staff of manufacturing engineers or people who understand lean thinking," Nickels says. "If we can give them some of our resources, they get savings in their manufacturing. We expect them to pass the savings along to us but they get to keep the savings for their other customers as well."

Collaborating closely not only helps the supplier, it also helps Herman Miller, Nickels insists, and not just in cost savings. "One of the reasons we're not very vertically integrated is because we want to stay flexible in terms of the type of manufacturing process we can use, the types of materials that we use in our products. If we had factories full of machines that put foam on chairs, we probably would have never allowed the development of the Aeron chair. We would have had this huge asset base that wouldn't be used under the new design and the new concepts," she says.

Improving working capital management

Logistics experts might talk a lot about on-time delivery and order flow, but one of the ultimate goals of better supply chain performance is to decrease the need to tie up assets in working capital. The more money that's tied up in inventory and the longer your customers take to pay you, the less you have to invest elsewhere.

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While inventory is to an extent the work of logistics experts, the other elements of working capital are clearly items over which the CFO has some control. Although Chris Roling, SVP of finance, logistics, and procurement at ICI Paints actually has both financial and logistical authority, hearing him talk about the company's 45 manufacturing locations in 25 different countries, which collectively produce approximately 50,000 SKUs, makes it clear why streamlining the company's cash flows might be high on his agenda.

To lower its receivables, ICI Paints has worked with customers to agree on terms to speed their payments and is considering outsourcing its collection function. At the same time, his team is also working on the payables side, trying to extend payment terms to their suppliers in exchange for "value-creating opportunities for both sides," Roling explains.

Finally, putting his logistical hat back on, Roling has tried to trim the third leg of working capital—inventory costs—as well. One initiative ICI is pursuing is supplier-owned-and-managed inventory, which is equivalent to what retailers call vendor-managed inventory (VMI). VMI is the lean-supply practice whereby the supplier holds ownership of the good until it is actually used, reducing the time it stays on the books as inventory, thus shrinking working capital.

The result: the working capital ratio at ICI Paints has dipped from 18 percent against total sales in the late 90s to about 10 percent now. Roling is hopeful that there's more progress to come, since these changes have been made even before moving on to many other items on his list of plans for supply chain improvement —building a hub-and-spoke regional manufacturing system, reducing the number of SKUs, and implementing a major restructuring effort in the company's North American and European manufacturing operations that will lead to a streamlined and more integrated supply chain.

Increasing inventory transparency

For many CFOs, inventory metrics—such as days-on-hand inventory or inventory turns—are an important window on supply chain performance. But obtaining accurate information about inventory, particularly for companies with complex or specialized processes, is easier said than done; as mentioned in Chapter 2, 30 percent of CFOs report that they have incomplete inventory data. (Indeed, the emphasis on inventory metrics may reflect a desire to see improvement in this area.)

Some CFOs have been able to help drive better inventory management by ensuring that the ERP implementation process runs smoothly

To get better information about their supply chain, many companies have installed enterprise resource planning (ERP) systems. These systems, which can add transparency to the supply chain, have a reputation for being difficult to implement—and, ironically, on some well-publicized occasions have even inadvertently stopped all production. But perhaps because setting and following protocols is a strong suit of financial professionals, some CFOs have been able to help drive better inventory management by ensuring that the ERP implementation process runs smoothly (see case study, next page).

But views on the value of ERP systems vary. A number of executives—both those whose companies have such systems and those who don't—say that much of the benefit of such enterprise-wide systems may be less the systems themselves than the effort that goes into simplifying the supply and production process before putting a system into place.

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Boehringer Ingelheim: ERP, ASAP

While it's true that a good ERP system can provide better control over inventory, it's also true that a botched implementation can be worse than having no system at all. Some CFOs have concluded that an ERP implementation is too important to be left to the IT or supply chain professionals.

Holger Huels, senior vice president and CFO of pharmaceutical manufacturer Boehringer Ingelheim U.S.A., says that when his company decided to install an ERP system across its supply chain, he and other senior managers took several steps to make sure that the development did not spin out of control.

The first step, he says, was to make sure that all the decision makers agreed on necessary functionality, taking care to make as few modifications as possible. They weren't allowed to leave the room until a decision was agreed on, he says. Next, he says, they all had to resist the temptation to add functionality as the system was being built. Even Huels found himself wanting to squeeze in a few new features, but he says he resisted the impulse.

In the end, the executive team's restraint paid off. The system was completed in 13 months—and finished on schedule and under budget. Huels and supply chain chief Ron Fronk both admit that they are pleased with the results of their relatively uncustomized ERP system, which they say has helped increase inventory turns from about 1.9 annually before December 2000 (when the system went live) to a respectable 4.0 now, and reduced the number of customer back orders. But Fronk says that he believes the biggest improvements were the result not so much from the implementation of the technology as the planning process it took to get there.

"I think the key thing is that it's not so much the software, but the implementation process. We re-examined all of our processes. We redesigned the way we were going to approach the business, and then laid that concept into the system. So, we're much more visible to each other," Fronk says. "The communications within all of our organization—marketing, finance, manufacturing—is light-years ahead of what it was before we went through this process."

Strengthening customer service

While many CFOs take naturally to cost-cutting and inventory management, fewer attempt to influence the end of the supply chain that meets the customer. But as our survey results show, improving customer service ranks high on CFOs' list of supply chain objectives.

Some of the finance executives we spoke to are taking steps to improve this part of the supply chain, understanding that doing so can have a direct impact on revenues. Heineken U.S.A., for example, has been overhauling its distribution system to better serve the local distributors it sells to (see case study, next page).

Labatt U.S.A. is also working to improve customer service, according to CFO Graham Staley. Staley says that his company is trying to think more about the needs of the retailer and the distributor, and design delivery systems around those needs. "We're trying to put ourselves in the shoes of the retailer and the wholesaler and say, 'How can we make doing business with our company a lot easier?'"

One key initiative in this effort began last fall, when Labatt took on the responsibility of delivering its beers to the suppliers. It's an effort, Staley says, that is intended not so much as a way for the company to trim its own costs as to promote closer ties with its distributors and build more efficiencies throughout the distribution system.

Staley says he believes people sometimes overlook the sales value of supply chain improvements. "It's not just a necessary evil, it's an opportunity to sell. [We're] not just selling beer. In our case, we're selling service, we're selling support, we're selling understanding, we're selling experience—we're selling all these touchy-feely things which are actually worth something."

Heineken: Reaching parts other beers miss

In England, Heineken used to be marketed as "the beer that reaches the parts other beers miss." That slogan has gone to advertising heaven now, but it might well be the secret motto of Heineken U.S.A.'s supply chain team.

Over the past six years, the company has completely revamped its distribution system to make itself more competitive with domestic beer companies such as Anheuser-Busch. Most of these changes have served not to reduce cost, but to better supply the company's 425 independent local distributors.

Thanks to a number of restrictive, Depression-era laws, beer is distributed through a three-tier structure in the U.S. This means that before any of its green bottles reach store shelves, Heineken must first deliver its goods to a network of local distributors. Keeping those distributors happy is therefore a high priority. CFO Rodolph Italianer says that this structural fact has led the company to focus many of its supply chain improvements first on its most important customers—those local distributors—before considering cost savings for itself.

Balancing the need for inventory with the aim of reducing working capital is "a difficult dance," says Italianer, "but you always have to put the customer first."

Now the effort seems to be paying off: Italianer says that thanks to a national warehouse network opened in 2000 and 2001, and to its more advanced online ordering system (the company launched its latest online ordering portal, the SAP-integrated StarLink, in May 2003), Heineken U.S.A. can now fill orders much more quickly than most imports. He says the company can fill an order in eight days compared with the 18 days typical of an importer. Not only is this fast enough to beat most imports, but the speed of the system now even matches the order-filling performance of domestic giant Anheuser-Busch, according to Italianer.

Building warehouses might seem heretical to the lean supply orthodoxy, but Heineken has tried to reduce the cost by working with third-party logistics providers. The warehouses, for example, are owned and managed by another company. This has reduced the amount of company assets tied up in distribution, he says. It has also added flexibility: when a warehouse in Seattle didn't work out as well as planned, Heineken was able to just fold West Coast operations into its Oakland distribution point.

Such outsourcing has helped keep Heineken focused on its most important tasks, according to Italianer. "Our core competency in the U.S. is marketing and selling beer," he says. "We don't want to be logistics experts."

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Conclusion

Critic and humorist H.L. Mencken once said that to every problem there is a solution that's simple, easy—and wrong. It's an aphorism that seems applicable to building efficiencies in today's complex supply chains. When it came to the benefits of adding technology or following lean supply practices more closely, the CFOs we interviewed and surveyed could see no simple or easy answers, just many opportunities and a lot of hard work.

But the CFO is better positioned to drive changes in the supply chain than many. As the holder of the financial levers, the finance executive is accustomed to thinking clearly about the hard choices and the inevitable tradeoffs the firm faces. As Mike Mullen, CFO of AmerisourceBergen Specialty Group puts it, "An effective finance team helps an organization see around the corners by framing the implications of the bets that are being made in a constantly changing game."

The challenge extends beyond the traditional bounds of CFOs' expertise. With the rise of outsourcing and the growing fluidity of the firm's boundaries in both supply and distribution, CFOs will need to develop a range of knowledge and skills even wider and deeper than what they have already acquired.

In particular, as many CFOs we surveyed say, there is much work to be done in improving their understanding of the sources of value and cost in both the internal and external supply chains. For instance, a number of CFOs interviewed say that it's vital for CFOs to cultivate a deeper understanding of where value is truly created when it doesn't show up in a particular metric. As Beth Nickels of Herman Miller advises, "it's important to take the time to understand the business and the whole value chain and not to focus just on price."

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Five recommended actions for CFOs

Our research suggests five ways the CFO can help the supply chain management team:

1. Keep their eyes on the prize. One of the things we heard over and over in our interviews is that CFOs believe they can add value by making sure that major supply chain projects stay focused. Huels of Boehringer Ingelheim U.S.A. says one reason he was able to keep the development of a new enterprise planning software system on schedule was that he did not allow any changes to the product's specifications once they were initially agreed to by management—not even when it was extra functionality that he wanted.

2. Don't wait for that new machine. While ERP systems can be useful, CFOs say that much can be accomplished with something as humble as a spreadsheet. "I am very much of the opinion that the systems are not the cure-all," says Roling of ICI Paints. "There is quite a bit that we can do even with slashed IT budgets. A lot of it is common sense. A lot of it is back to basics. A lot of it is, quite frankly, focus."

3. Get out more often. Today's lean supply chain is changing the boundaries between suppliers and customers. CFOs say that these close relationships, which rely on transparency and trust, are providing important new ways for financial executives to add value. For some CFOs, that may mean providing financial advice to a supplier, as financial executives do at Lear Corporation. For others, it might mean generating an estimate of a client's cost savings in a potential outsourcing relationship, as financial executives do at Industrial Distribution Group. Upstream or down, the CFO's perspective seems to be an increasingly important element in making inter-company partnerships thrive.

4. Ask a lot of questions—and listen to the answers. Of course, sometimes what needs to be done is apparent but difficult to demonstrate on a spreadsheet. Mullen of AmerisourceBergen likens the situation to deciding to buy a new carpet in a restaurant. Although everyone might agree that the carpet's looking shabby, it's hard to specifically quantify the impact on sales and profits. In analogous situations within the supply chain, CFOs need to understand how their colleagues are defining value before they kill an idea.

5. Think about value, not price. "It's so easy for us as accountants to look at, 'How much did you pay for that piece? How much did you pay for it last year?'" says Nickels of Herman Miller. "We use the difference to determine if the procurement folks added value. I think that's the wrong way to think about it. We have to force ourselves to first figure out what the strategy is of the business, to understand the business, and know how the value chain can best support it."

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APPENDIX

Industry variations

Our research found significant differences among the three major industries we examined (manufacturing, health care, and retail/consumer products). The following figures show how the different industries responded to a number of the survey questions.

Figure A1: How much impact does the supply chain have on your strategic objectives?

% respondents

	The most important factor	A large effect	A moderate effect	A slight effect	None
Manufacturing	5%	69%	20%	6%	0%
Retail/Consumer products	8%	60%	26%	5%	1%
Health care	2%	48%	36%	13%	1%

Source: CFO Research Services

As Figure A1 shows, executives from manufacturing and retail/consumer products companies believe that the supply chain has a greater effect on strategy than health care executives do. This reflects the nature of these industries: manufacturers and retail/consumer products companies are primarily focused on delivering physical products to customers. For health care companies (most of whom in our sample are HMOs and large hospital organizations), the focus is on delivering a service that is somewhat less dependent on the supply chain.

Figure A2: What problems do you see with supply chain management at your company?

% respondents

	Manufacturing	Retail/Consumer products	Health care
Difficulty accurately forecasting demand	69	61	58
Too much unmanaged supplier risk	38	44	34
Supply chain processes not managed in one place	34	34	38
Unclear lines of authority	33	33	36
Incomplete information about inventory	23	23	41
Lack of senior management leadership	31	18	19
Supply chain unresponsive to changes in strategy	28	18	18
Other	3	1	14

Over 40% | 20-39% | 1-19%

Source: CFO Research Services

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Figure A3: The gap between supply chain importance and performance

Of those saying process is very important,
% who say they have high performance

	Manufacturing	Retail/Consumer products	Health care
Customer relationship management	47	55	70
Manufacturing/Operations management	75	55	70
Cash management	76	96	87
Logistics/Fulfillment	80	55	80
Procurement/Supplier management	70	64	83
Supply chain strategy development	48	56	74
Product development/design	68	55	79
Corporate planning	78	57	58

Over 80% | 60-79% | Under 60%

Source: CFO Research Services

Overall, manufacturers are more likely to see problems with supply chain management than other kinds of companies. Difficulty forecasting demand is the top issue across industries. Retail/consumer products companies are somewhat more concerned about supplier risk, perhaps reflecting the prevalence of overseas contract manufacturing in those industries. Health care respondents are more troubled by a lack of information about inventory.

As Figure A3 shows, retail/consumer products companies see the biggest gaps between process importance and performance. For example, of those retailers who see logistics as very important, only 55 percent think that this activity is done very well at their company. Health care executives appear the most confident about process quality. Given the traditionally wide profit margins in this industry however, this may be more of a reflection that, at many companies, these processes haven't been required to perform under the intense competitive pressure that retailers and manufacturers face.

Fig A4: How important are the following supply chain objectives for your organization?

% responding "very" or "extremely" important

	Manufacturing	Retail/Consumer products	Health care
Reduce operating costs	94	90	98
Improve customer service levels	89	86	83
Increase perfect orders	81	84	66
Improve inventory performance	80	82	67
Improve production cycle times	73	49	48
Improve working capital	73	78	72
Reduce logistics/distribution costs	73	84	80
Improve manufacturing efficiency	69	35	31
Improve sales/market share	67	84	44
Improve fixed asset management	39	27	41

Over 80% 60-79% Under 60%

Source: CFO Research Services

Cutting operating costs and improving customer service are priorities across all three industries. Manufacturers are more likely to concentrate on production cycle times and manufacturing efficiency, and retail/consumer products firms are more focused on cutting logistics costs and improving sales. Improving fixed asset management is a low priority for the three industries, reflecting today's low cost of capital.

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UPS Consulting

SPONSOR'S PERSPECTIVE

- By Gene Long, President, UPS Consulting

A company's supply chain provides a competitive advantage that has historically been vastly underrated. And now CFOs, caretakers of value creation, have an opportunity to take a more definitive role in the management of the supply chain, which impacts, on average, 75 percent of operating results.

As this study points out, most chief financial executives view the supply chain as crucial to their companies' success and recognize the value of a well-executed supply chain management strategy. We see this as a natural evolution. It is a call to action to join with other key company leaders and take a hard look at how they expect to oversee, control, and guide supply chain operations.

Our experience in discussions with senior management validates this study's findings that most CFOs are concerned about the lack of alignment between supply chain operations and their company's business strategy. This puts them ahead of the curve. In fact, most cite essential differences between the business plan and performance. This gap reveals opportunities for companies, and CFOs are clamoring for greater license to resolve this disparity.

As one of the largest determinants of where cash flow will be derived and where capital will be consumed, the supply chain seems a natural area of involvement for the CFO. From that perspective, creating a plan that supports the business strategy and then executing that plan to maintain the financial success of the company creates an inextricable link between how well the supply chain operates and what finances the CFO ultimately has to manage.

We often tell companies that oversight of supply chain operations not only deserves but also requires the same degree of finesse and skill as other primary operations of a business such as sales, production, or marketing. That's why applying the skills and analytical abilities of the CFO to supply chain operations could put the company at a greater advantage.

What we find within too many companies are sets of influential managers who, without the benefit of singular oversight, countermand one another. The trick is getting this vertical level of management to think beyond their own department or business function to consider instead the impact of each decision on the entire company.

In the past, CFOs have been charged largely with keeping down costs. During the last decade, some companies have become almost expert at removing costs and inefficiencies from their supply chains. Often the result has been very effective, well-oiled machines that produce very inflexible supply chains. This one-size-fits-all solution falls considerably short in a market that continuously demands customization and adaptability. The CFOs surveyed recognize the need for flexibility.

Just as important, the survey points out that CFOs also understand the need for better customer service. We know all too well that it's too easy to focus only on operational savings at the expense of customer service—gains that ultimately translate to a loss in business.

The inability to make changes within the supply chain to meet the market's fluid needs can cause companies to miss valuable opportunities—or worse, create opportunities for their competitors. As the guardians of market value, who is better positioned to get their arms around supply chain management than the CFO?

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