IS YOUR SUPPLY CHAIN IN A DEATH SPIRAL?

Andrew Corr
Only 33 percent of operations executives see their cost intervention initiatives as durable.¹ That’s because companies are trapped in a supply chain cost reduction death spiral. They chase incremental savings when they could be radically shifting cost curves, boosting performance across the supply chain and creating new value to fuel sustained growth.
NO MORE COMPROMISES

Growth is slowing in consumer markets. Competition is intensifying. Product life cycles are speeding up.

These forces are creating rising pressure for companies to free up cash to drive growth through acquisitions, product innovation and digital technologies. With half of companies’ costs typically residing in the supply chain or cost of goods sold (COGS), it is no surprise that reducing supply chain costs is a major focus across industries.

What is surprising, and problematic, is that few companies are realizing cost savings for competitive agility. Mired in backward-looking cost optimization that forces no-win compromises between growth, profitability and sustainability, supply chain executives are stuck in an endless loop.

They constantly try to eke out 3 to 4 percent in category reductions year after year. But many never make a sustainable bottom-line impact on COGS, with most companies seeing no or minimal change in COGS-to-revenue ratios over time.

Leading companies are breaking this cycle with ZBSC (zero-based supply chain)—part of ZBx² (zero-based mindset), a way to drive profitability that emphasizes the future over the past. By continually improving results, ZBSC offers a coveted competitive advantage. The ability to capture supply chain value in a rapidly changing world.

Accenture Strategy experience reveals that ZBSC approaches can drive 5 to 10 percent rapid COGS savings and a COGS-to-revenue ratio of up to 800 basis points over time.
It is not that supply chain executives have turned a blind eye to systemic supply chain issues. Companies are doing cost optimization across the supply chain.

But most are not getting sustainable results. Only one-third of operations executives strongly agree that they see the results of their cost reduction initiatives in the P&L statement. Even less (18 percent) are confident that leadership has the right initiatives in progress to achieve cost reduction targets. An analysis of 20 leading products and consumer companies shows that since 2010, most have seen COGS as a percent of sales remain stable or increase, even though almost all have continuous improvement and COGS focused reduction programs. The top companies have seen only 2 to 3 percent improvement.

Many organizations work in functional and geographic silos that make it impossible to know who is spending what, where—and why. Consider that 48 percent of executives named intuition as one of their top three tools. This is why cost optimization efforts rarely identify the root causes of price and performance issues. Nor do they accommodate the latest digital technologies to determine the “should cost” of supply chain categories to help future-proof their supply chains.

Supply chain leaders may deliver single-digit category savings in one area only to find costs ballooning elsewhere and no noticeable or sustainable change to the bottom line. This is essentially cost avoidance. Simultaneously, they are creating savings fatigue across their supply chain organizations by asking for more with little-to-no real bottom-line improvement.

Consider these examples. A personal care company was driving 3 percent improvement in COGS. Even though the company reduced costs in existing products, costs for e-commerce and new products were on the rise. As a result, actual value to the bottom line showed an increase of 1-percent over the period. A global food company had a continuous improvement program that was lauded for reducing logistics costs by 4 percent year over year. But the program barely kept overall logistics-to-revenue ratios flat over the same period. Leadership soon demanded more bottom-line impact.

These stories reveal an inconvenient truth. That as-is supply chain cost optimization does not deliver sustainable results in costs, growth or agility. Operations executives are acknowledging this challenge. Just one in five think that their cost intervention program delivers flexibility and operating model simplification. Only 24 percent say they have an agile operating model that is fit for purpose.
BUILDING BLOCKS OF ZERO-BASED SUPPLY CHAIN

CLOSED LOOP
A closed loop approach using forensic analytics and insight from company and industry best practices addresses true, not perceived, gaps and enables continuous renewal.

VISIBILITY
A single, granular view of all cost elements and overall performance with an integrated set of optimization levers lowers variable manufacturing and logistics costs as well as fixed costs.

COST-CONSCIOUS CULTURE
Hunting for isolated savings gives way to incorporating savings into the budget and establishing accountability and transparency to create a cost-conscious culture.

FUTURE-FOCUSED
Instead of reducing costs by an arbitrary percentage based on historical data, companies start at a zero base, asking what costs should be based on market realities and future needs.

STRETCH PERFORMANCE
By creating benchmarks using digital technologies and sustainability strategies, companies can stretch organizational performance and targets aligned with growth goals.
Supply chain executives at a global beverage company did things differently to get past these challenges, and have been using zero-based approaches for a decade.

The company had implemented zero-based budgeting across non-direct spend, but wanted to expand this to COGS to free up money to drive growth. ZBSC created cost visibility using a category approach across all direct spend. Defining “should costs” opened the potential value gap. And a value targeting approach, leveraging internal and external best practices across cost categories, provided specific actions to close it. The company created a sustainable closed loop to improve every year, pulling out more than 800 basis points from the COGS-to-revenue ratio since the beginning of the decade. The company has also taken a forward-looking view and has made the commitment to shift 100 percent of its purchased electricity to renewables, reducing its carbon footprint by 30 percent. Not only did it do the right thing for the environment and its brand, but it also shifted its cost curves.

In addition, the company used this capability to create a repeatable process to unleash value from its acquisitions. It rapidly applied this approach with a major acquisition to capture more than US$500 million in operational improvements in less than 18 months.8

This is the power of ZBSC. It identifies COGS “should costs” as well as cost reduction opportunities across price, performance and value engineering while optimizing product and service complexity. ZBSC is more than hunting down old costs in new ways. It requires a mindset shift and cross-organizational efforts.

By applying ZBSC, companies no longer push for the next percent of hoped-for savings. They embed a new way of thinking and working that constantly enables new ideas about where and how to capture value that can be funneled back to growth. While ZBSC uses many principles from lean and Six Sigma, it creates more visibility, broader accountability and more rigorous zero-based goal setting and budgeting.
Continuous renewal makes ZBSC different from traditional supply chain cost optimization.

Whereas old methods rely on cost targets based on yesterday’s realities, ZBSC is a sustainable reset of a company’s cost baseline. It accounts for change and improvements of top performers and technology to determine “should costs” and develops a path to realize them.

The adaptive nature of ZBSC reflects the fact that it does not rely on past performance or even first quartile benchmarks from the past. It continually strives to develop a new “quartile zero” to set and stretch performance targets. Compare this to existing continuous improvement programs. By the time a company makes the necessary improvements to meet historical benchmarks, those benchmarks have advanced. With ZBSC, companies apply digital technologies and sustainability practices that optimize price and performance across global operations and enable richer data insight and value.

ZBSC helped a global products company under major cost pressure continuously reset its baseline yearly. The company expanded existing zero-based principles to COGS, with an initial focus on logistics. It broke down barriers across business units and regions for granular visibility into cost and operational performance across transport and warehouse operations. A future quartile zero vision applying advanced analytics and technology impact across the supply chain—including automation for picking and packing and warehousing, and predictive analytics for optimizing movement and modes of raw materials and finished product—helped the company reset targets. The organization has identified more than 20 percent cost reduction opportunity across the network and captured 12 percent in the first 12 months.³
Additionally, ZBSC encourages companies to embrace sustainability to reset supply chain categories such as utilities, raw materials and packaging.

Consider how a clothing company designed a line of clothing using materials from old shoes and shirts and transformed them into new, high-performance gear. The company used 82 percent recycled polyester fabric and 13 percent recycled plastic bottles, which dramatically affected its “should costs” of raw materials across these product lines—reducing costs and driving profitability.¹⁰
AN END TO
ENDLESS LOOPS

There is a way out of the supply chain cost reduction death spiral.

Breaking free requires making bold people, process, culture and technology changes while embracing continuous improvement and embedding cost-consciousness across the organization. Companies can start with these fundamentals:

CREATE TRUE VISIBILITY
Leverage financial and operational data to achieve complete visibility at a granular level and understand the current state against internal and external practices. This is key to open the gap, define “should costs” and prioritize focus to unleash value.

FOCUS ON THE INTERSECTIONS
Develop organizational incentives that encourage collaboration across geographies and functions to identify and target opportunities at intersections of the business where best practices and emerging trends are often hidden.

STRETCH PAST INCREMENTAL
Think outside the box and embrace technology, analytics and sustainability opportunities to set zero quartile goals and future-proof the supply chain.

EMBED A CHANGE MENTALITY
Drive support from the top all the way through the organization. Establish the right communications, incentives, tools and role modeling to make efforts part of the future fabric of the company—a closed loop rather than a one-time event.
Companies cannot afford supply chain trade-offs. For too many, cost optimization, technology, growth and sustainability are mutually exclusive. ZBSC is a starting point to harmonize these goals. Finally, there is a new way to deliver superior supply chain performance at the right cost—while fueling growth and increasing competitiveness.
About Accenture

Accenture is a leading global professional services company, providing a broad range of services and solutions in strategy, consulting, digital, technology and operations. Combining unmatched experience and specialized skills across more than 40 industries and all business functions—underpinned by the world’s largest delivery network—Accenture works at the intersection of business and technology to help clients improve their performance and create sustainable value for their stakeholders. With approximately 442,000 people serving clients in more than 120 countries, Accenture drives innovation to improve the way the world works and lives. Visit us at www.accenture.com.

About Accenture Strategy

Accenture Strategy operates at the intersection of business and technology. We bring together our capabilities in business, technology, operations and function strategy to help our clients envision and execute industry-specific strategies that support enterprise-wide transformation. Our focus on issues related to digital disruption, competitiveness, global operating models, talent and leadership helps drive both efficiencies and growth. For more information, follow @AccentureStrat or visit www.accenture.com/strategy.

Notes

1 Accenture Strategy Agility to Compete Research 2015.
3 Accenture Strategy Agility to Compete Research 2015.
4 Accenture Strategy analysis.
6 Accenture Strategy client experience.
7 Accenture Strategy Agility to Compete Research 2015.
8 Accenture Strategy client experience.
9 Ibid.

The use of such trademarks herein is not an assertion of ownership of such trademarks by Accenture and is not intended to represent or imply the existence of an association between Accenture and the lawful owners of such trademarks.