



*Align costs with business strategy*

# ***Managing operational performance in volatile times***

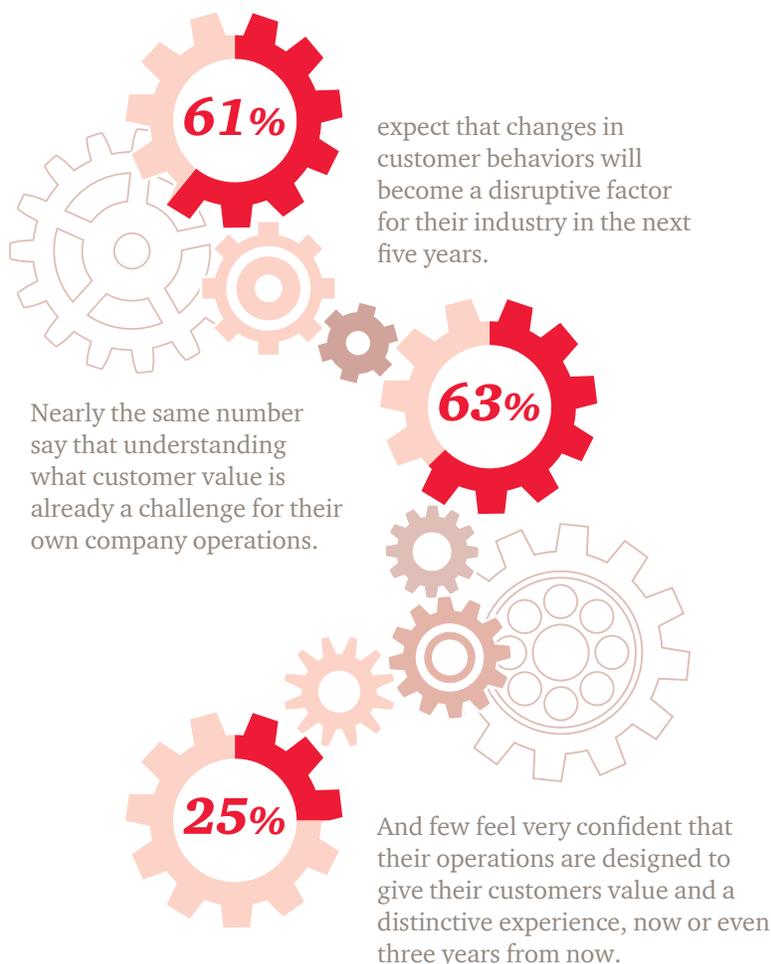


## Aligning business outcomes and operational performance

The past 15 years have seen unprecedented business volatility on multiple fronts — economic, social, political, natural, and technological — which has continually tested executives' ability to adapt and deliver excellent operational performance. Adding significantly to this challenge, rapidly changing customer needs and demands during the same period have dramatically increased pressures

on supply chains. Companies need to deliver an expanding variety of products at lower cost and greater speed. Many companies are struggling to continually refine their understanding of customers' needs and to align and adapt their operations in new and differentiating ways. PwC's [Global Operations Survey](#) of more than 1,200 operations leaders from around the globe found that 63 percent consider understanding what customers value to be a challenge for their own company's operations. Moreover, the survey found that more than three out of five (61 percent) operations leaders expect continued customer-driven disruption over the next five years — the single largest expected source of disruption among the responses. Consequently, only a minority of the operations executives polled (25 percent) are very confident that their operations are designed to give their customers value and a distinctive experience, now or even three years from now (*see Figure 1*).

Figure 1: The challenge of dynamic customer needs





Although aligning operations to dynamic customer needs is a pressing and constant challenge, it also represents a significant opportunity for achieving competitive advantage. Research presented in *Strategic Supply Chain Management: The Five Core Disciplines for Top Performance*<sup>1</sup> highlighted the considerable top-line and bottom-line benefits of strategically aligned operational performance. In that research, the best-in-class operations companies — those with excellent performance across a balanced set of operational performance metrics — generated 50 percent higher sales growth and 20 percent greater profitability than their industry peers. But what are the keys to aligning operations and becoming a best-in-class operations company?

**Best-in-class**

operations companies generated

**50% higher sales growth...**

...and **20% greater profitability** than their industry peers.



**Insights from PwC's Performance Measurement Group Supply Chain and Operations Benchmarks**

As part of our continued efforts to help clients adapt and improve operations and achieve competitive advantage, we examined trends in operational performance over the past 15 years. Utilizing proprietary operational performance data from PwC's Performance Measurement Group (PMG), we analyzed customer delivery reliability and speed, inventory, and supply chain costs to determine where best-in-class operations companies have led the way. Three main themes emerged:

<b>1</b> <b>Customer service:</b>	Putting the customer first
<b>2</b> <b>Inventory and working capital:</b>	Moving from "reduce" to "optimize"
<b>3</b> <b>Costs:</b>	Controlling costs while upgrading capabilities

<sup>1</sup> Shoshanah Cohen and Joseph Roussel, *Strategic Supply Chain Management: The Five Core Disciplines for Top Performance* (McGraw-Hill Education, 2013).

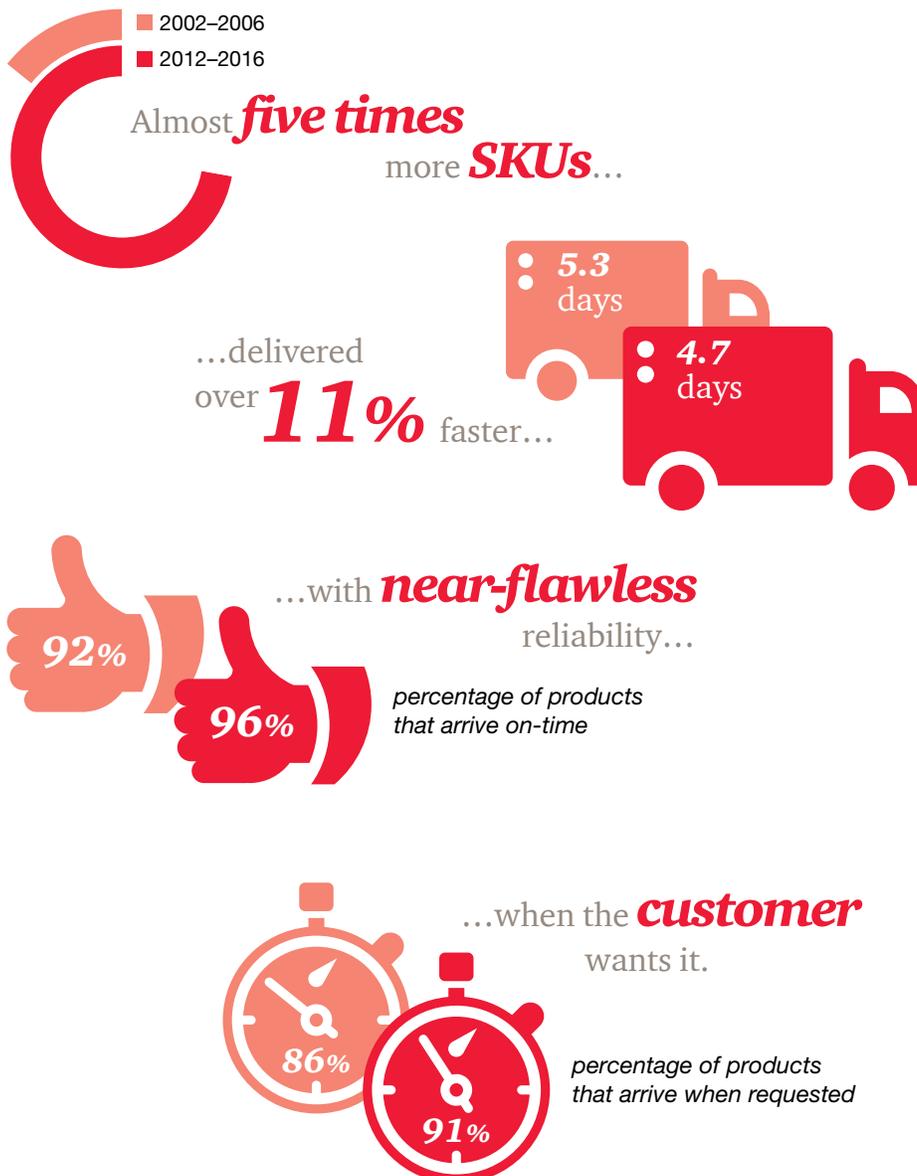
**Theme #1: Customer Service:  
Putting the Customer First**

Reliable delivery of products, as measured by *on-time delivery to commitment*, was once a differentiating performance metric. However, it has become “table stakes” for most supply chains; median success on this factor is nearly 96 percent. As business volatility has increased and customer demands have heightened, top-performing companies have increasingly focused on responsiveness to their customers,

as measured by *on-time delivery to customer request*. Already having mastered meeting delivery commitments (with a success rate of more than 99 percent), the leading companies have raised their performance in meeting their customers’ requested delivery dates, with nearly 99 percent on-time delivery to request. In comparison, median companies have raised their performance in meeting their customers’ requested delivery dates to over 91 percent, or approximately 8 percentage points lower than leading companies.

As operations executives know all too well, customer demands for increased product variety, as measured by SKU counts, have made achieving *on-time delivery to customer request* levels above 90 percent much more difficult. Over the analysis period, 2012 to 2016, product variety, driven from the consumer all the way back through the value chain, increased dramatically (see Figure 2). Moreover, all of those new SKUs had to be delivered to customers faster than ever, with average order fulfillment lead times decreasing over the analysis period by 11 percent, from 5.3 days to 4.7 days.

**Figure 2: Supply chains have responded to customer demands**



The ability of companies to greatly increase complexity while also achieving higher levels of delivery reliability with shorter lead times is impressive, and has been made possible, particularly among best-in-class companies, by significant improvements in operational capabilities. These notably include critical supply chain capabilities such as strategic supplier management, network and inventory optimization, and integrated business planning. Another emerging area of focus is around tailoring supply chains based on varying customer requirements, demand characteristics, and supply capabilities. Leaders recognize that one size does not fit all. They’ve created different supply chain configurations for different customer segments by using distinct processes and supply networks to offer different levels of service at different prices. They’re also more focused in the ways they go to market. Clear channel focus, while configuring the supply chain to meet the needs of individual customers, has proved to be a winning formula.

Data represents performance of median companies.

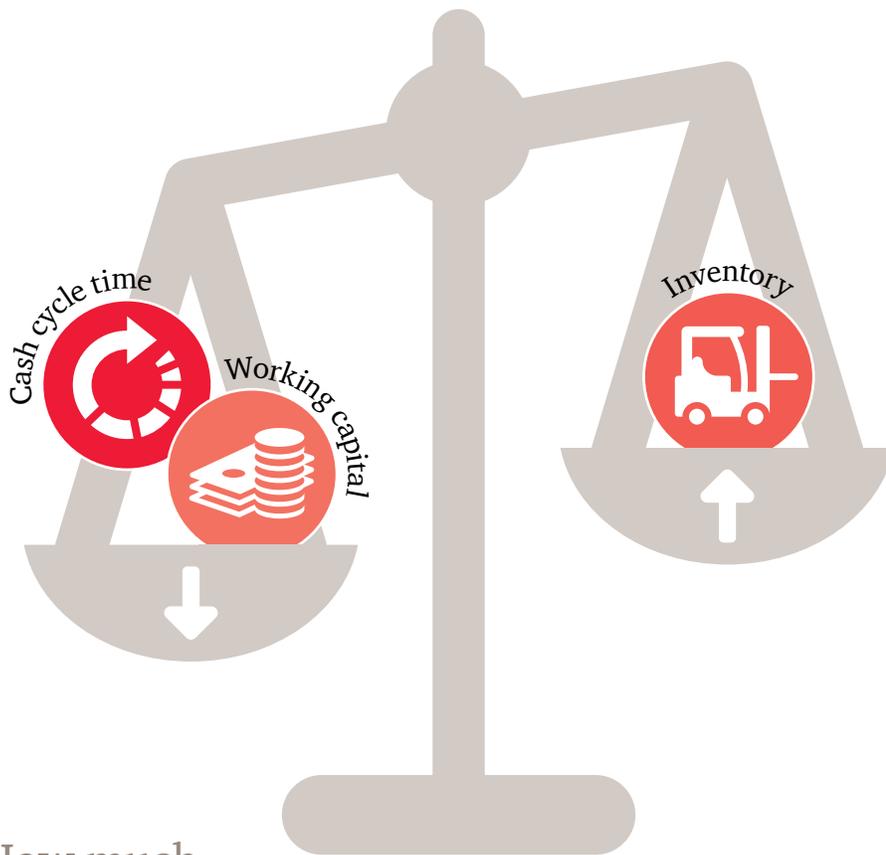
## Theme #2: Inventory and Working Capital: Moving from “Reduce” to “Optimize”

The operational improvements undertaken to meet escalating customer demands have not come without costs. Much has been written about inventory increases over the past decade, and the PMG benchmark data supports these inventory-related findings. Median inventory levels (measured as days of supply) increased 9.6 percent over the analysis period.<sup>2</sup> This makes sense,

because holding more inventory can be the fastest and most direct way to meet the customer demands for more products, delivered faster and more responsively. Unfortunately, this approach has put balance sheets under constant pressure.

To offset the burden of holding more inventory, companies have pressured suppliers for longer payment terms and, where possible, have sought faster payments from their customers. Over the analysis period, the net payable–receivable cycle improved from +9.1 days to -7.3 days, a huge swing. These tactics have helped relieve some of the pressure on balance sheets, reducing total working capital levels by 11 days, but most companies have likely reached their limit (see Figure 3).

Figure 3: Inventory remains a major challenge



How much  
**more** can you  
**squeeze** out of your **customers**  
and **suppliers**?

That brings the spotlight back to inventory. Further operational improvements will depend on companies’ wise investment in the capabilities necessary to further improve inventory management, such as advanced demand planning, multi-echelon inventory optimization, advanced planning and scheduling, and especially analytics and IT enablement in these areas. Without strong planning and inventory management capabilities, the inventory-for-service “investment” is a poor one, requiring larger-than-necessary increases in inventory to achieve modest, if any, improvement in customer service.

<sup>2</sup> Analysis period is defined as the difference between 2002-2006 and 2012-2016.

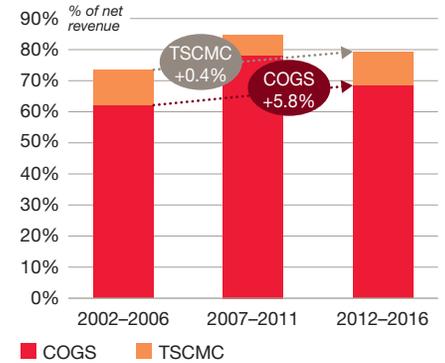
**Theme #3: Costs: Controlling Costs while Upgrading Capabilities**

As with inventory, the PMG benchmark data shows that both product and operational costs have been under pressure as customer demands for operational speed, reliability, flexibility, and responsiveness have increased. Both product costs, as measured by cost of goods sold (COGS) as a percentage of revenue, and operational costs, as measured by total supply chain management costs (TSCMC)<sup>3</sup> as a percentage of revenue,

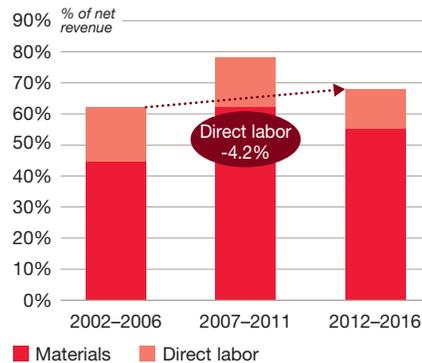
increased over the analysis period. Of the two measures, product costs, and specifically purchased materials costs, are often more difficult for an individual company to control, and they rose by more than 5 percentage points relative to revenues over the analysis period. The pressure of COGS increases on profitability has been offset to some degree by aggressive cost management in the more controllable TSCMC. Yet even these costs have only just held the line; median supply chain costs have increased slightly over the analysis period (see Figure 4).

**Figure 4: Cost pressures have driven shifts in priorities**

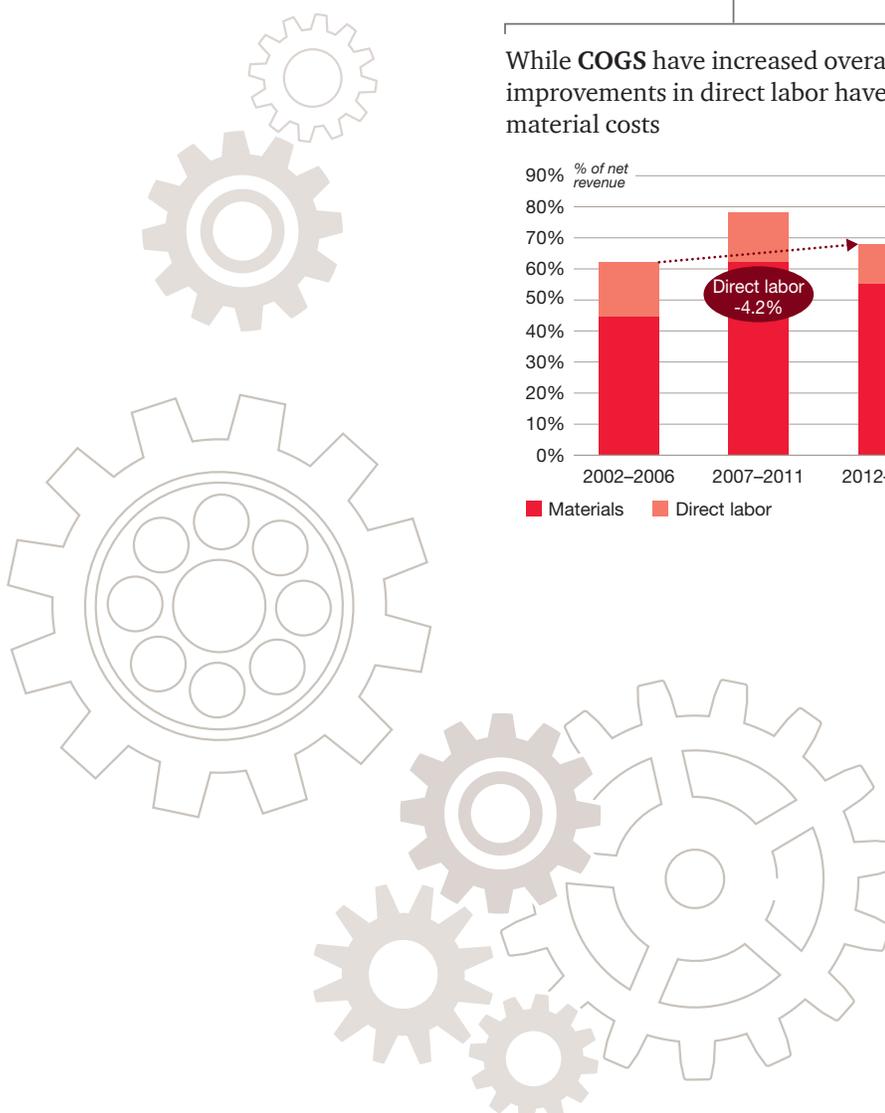
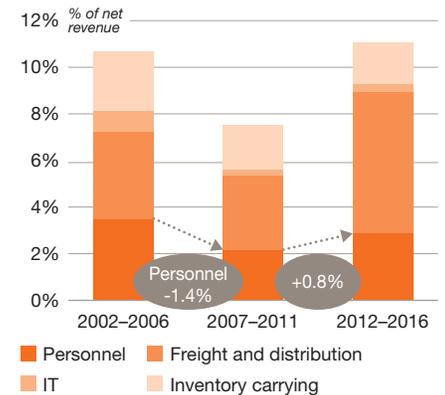
Tight supply chain cost management has helped offset COGS increases



While COGS have increased overall, improvements in direct labor have offset material costs



Coming out of the recession, companies are increasing their TSCMC spend in supply chain personnel



<sup>3</sup> Total supply chain management costs include the non-product costs for operating the end-to-end supply chain: material acquisition, order management, supply chain planning and finance, inventory carrying, and supply chain IT.

A deeper look into the cost numbers also show a fundamental shift in how spending priorities have changed. Capitalizing on the massive productivity increases of the 1990s and early 2000s, companies consolidated their gains by eliminating many lower-paying positions in manufacturing and operations, as evidenced by the dramatic increases in value-added productivity per employee and the significant decline in the labor component of COGS.

***Companies are now looking at different organizational, operating, and outsourcing models to more effectively source and utilize hard-to-find expertise.***

At the same time, and somewhat paradoxically, the human capital costs of managing the supply chain actually increased. During the analysis period, companies leveraged their IT investments to automate and eliminate lower-paying execution roles in supply chain operations, but added higher-paying planning and analytics positions. These higher-paying positions are essential to supporting many of the new capabilities that are needed to manage supply chains with the flexibility and responsiveness demanded by today's highly volatile environment. These trends are at the root of the increasing "war for talent," as companies seek supply chain and operations professionals with advanced analytics and planning skills. Companies are now looking at different organizational, operating, and outsourcing models to more effectively source and utilize hard-to-find expertise.<sup>4</sup>

## ***Looking Forward***

The challenges of the past decade have done much to shape today's operational priorities and performance. Continued increases in volatility and customer demands have made it essential to have highly efficient, flexible operations that can quickly accommodate smart trade-offs in the supply chain. Cost, speed, flexibility, reliability, and working capital are now tightly coupled in a highly integrated dance. Companies that make unilateral decisions to cut inventory or costs find themselves struggling to regain their standing with customers. But leading companies figured out what to do years ago. These best-in-class operations companies outperformed their industry peers by a stunning 50 percent in sales growth and 20 percent in profitability by taking a more strategically balanced view of operational performance across a broad, cross-functional set of metrics. In recent research that surveyed more than 1,200 operations executives, we found that only 15 percent exercised the full range of practices indicative of strong strategy-to-execution alignment; these elite companies were more confident on every key forward-looking business outlook. Having mastered the alignment of strategy and operational performance priorities, they are poised to extend their leadership by developing coherent capability systems that sense changing customer needs and execute them flawlessly.

<sup>4</sup> Joseph Roussel, "Making Talent Part of Your Supply Chain Strategy," Industry Week, Oct. 24, 2014, [www.industryweek.com/planning-forecasting/making-talent-part-your-supply-chain-strategy](http://www.industryweek.com/planning-forecasting/making-talent-part-your-supply-chain-strategy)

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## PwC's PMG benchmarking

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For more information on PwC's benchmarking services, please visit  
[www.pwc.com/us/benchmarking](http://www.pwc.com/us/benchmarking)