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May/June 2012 Volume 16, Number 3

SupplyChain Management Review

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FEATURES

10 The Competitive Potential of Supply Management

Supply management can be a powerful competitive weapon—if the strategy driving that activity is closely aligned with the business strategy. Yet new research suggests that the necessary alignment is often lacking. CAPS Research experts offer a process for identifying and implementing the supply management strategies that hold maximum potential for competitive advantage.

20 Creating Entrepreneurial Supply Chains

Entrepreneurs are widely known for their ability to conceive and generate innovative ideas that lead to business growth and profitability. Is there any reason why companies cannot apply the same entrepreneurial sprit to their supply chains? Author and educator William Lee says no. Here's his recipe for creating entrepreneurial supply chains.

28 S&OP: What You Can Learn from the Top Performers

The benefits of effective Sales & Operations Planning are compelling—lower operating costs, reduced inventory, and top-line growth. By realizing these benefits, says consultant Len Prokopets, the S&OP top performers also gain a significant market edge. The author details the traits of the top performers and gives practical advice on how to enhance your own S&OP performance.

36 Procurement Automation: How to Do it Right

Procurement automation can deliver a host of advantages. For one, automation eliminates the costly, time-consuming manual tasks while giving supply management professionals the tools and visibility needed to make better procurement decisions. Supply management expert Andrew Bartolini offers this guide to successfully implementing your procurement automation project.

44 M&As Offer Big Opportunity for Supply Chain Leaders

Merger and acquisition activity is set to be a prominent driver of growth for many businesses in the next few years. The upshot for supply chain chiefs in those companies: a fresh chance to produce significant shareholder value. Foster Finley and Jon Bonno of AlixPartners tell how to capitalize on that opportunity.

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Supply Chain Management Review® (ISSN 1521-9747) is published 7 times per year (Jan/Feb, Mar/Apr, May/Jun, July/Aug, Sept/Oct, Nov, Dec) by Peerless Media LLC, a Division of EH Publishing, Inc., 111 Speen St, Ste 200, Framingham, MA 01701. Annual subscription rates: USA $199, Canada $199, Other International $241. Single copies are available for $60.00. Send all subscription inquiries to Supply Chain Management Review, 111 Speen Street, Suite 200, Framingham, MA 01701 USA. Periodicals postage paid at Framingham, MA and additional mailing offices. **POSTMASTER: Send address changes to: Supply Chain Management Review, PO Box 1496 Framingham MA 01701-1496.** Reproduction of this magazine in whole or part without written permission of the publisher is prohibited. All rights reserved. ©2012 Peerless Media LLC.

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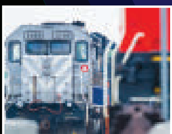
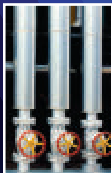
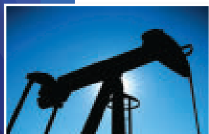

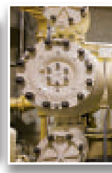

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Be Open to Innovation

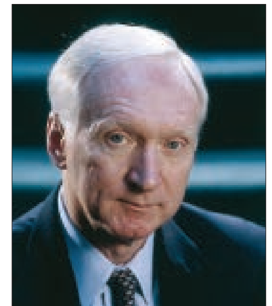
In the day-to-day rush of getting the job done, it's hard to think and act innovatively. We all get into our comfortable habits. Things are working well under the current system, customers seem happy, there are no major problems…so why mess things up just for the sake of being innovative?

Certainly, most of us have had this seductive line of reasoning creep into our psyches from time to time.

But upon reflection, it's clear that progress in any business or organization ultimately depends upon change—in thinking out of the box, in striving for innovation. That's one recurring message from this issue and it's one that should resonate with just about every supply chain professional in just about every industry.

In his feature article, consultant and long-time educator William Lee advocates for an "entrepreneurial" approach to supply chain management. he innovative aspect of such an approach, Lee says, is that it begins with the question, How can our supply chain contribute to profit and growth? (Not how should we modify our network or what new technology do we need.) The operations and supporting technology will follow, but the key driver is profit and growth. His five-phase approach for creating an entrepreneurial approach can help guide the process.

For researchers Robert Monczka and Kenneth Petersen, innovation in the supply management space means moving from a focus only on "core" strategies such as cost control and supplier quality to strategies that are more integrative and cross-enterprise in nature. As examples, the authors point to supplier integration into new product/service development and environmentally sustainable supply management initiatives. Only by stretching into these highly challenging areas, they say, can companies realize true transformation in the supply management processes.



Frank Quinn, Editor
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On that topic of transformation, our Spotlight on Supply Management column in this issue chronicles Best Buy's journey to become best-in-class in the procurement space. The effort required a huge change management initiative that affected virtually every aspect of the procurement function. A key to success: a willingness to embrace the change and move forward.

Finally, there's a huge opportunity to think innovatively in a merger or acquisition situation, write Foster Finley and John Bonno of AlixPartners. The conventional way of dealing with a merger—adding supply chain Number One to supply chain Number Two—no longer works in today's complex environment. What's needed is a comprehensive planning and implementation approach that considers financial targets and timing, operational synergies, and closely tracks and reports on results. For many, this represents a new way of thinking.

Supply chain innovation isn't easy. It takes hard work and a willingness to step out of the comfort zone—and, yes, take a bit of a risk. But it's the cornerstone of real progress. And if you're not pursuing innovation, you can be sure that your top competitors are.

Francis J. Quinn

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BY LARRY LAPIDE

Installed-base Supply Planning

Forecasting supply requirements for an installed base can be a tricky task. But a model called the Pot-of-Water can enhance the chances for success by carefully controlling and analyzing the inflows into the base—i.e., the pot—and the leaks.

Dr. Lapide is a lecturer at the University of Massachusetts' Boston Campus and is an MIT Research Affiliate. He welcomes comments on his columns at llapide@mit.edu.

I recently got a call from a colleague who was consulting for a business that leases pallets regarding how the client might improve demand forecasting. I had her describe the business model. And after hearing it, I told her that improvements might be made by recognizing that this was a business that generates revenues from an "installed base" (in this case, of leased pallets). Revenue is derived when pallets are actively used to store and move goods around. Pallets that are out of commission—such as ones broken or pilfered—generate no revenue. Thus, for the company to improve forecasting, it's important to understand what is driving the installed base of pallets to grow or shrink. Stated simply, whenever a pallet goes out of commission, the base shrinks; with the addition of a new leased pallet, the base increases.

We then discussed a forecasting and planning concept that I'm very familiar with in which the installed base is represented as a "Pot-of-Water" (P-of-W). In applying this concept, businesses strive to raise the level of water in the pot—by increasing the revenue base. I've had occasion to discuss this model with managers from sundry industries who have expressed great interest. So I decided to make it the topic of this column.

Installed-base Businesses

Many installed-base businesses rely on annuity-like revenue streams derived from annual or multi-year service contracts. To give one example, I was a forecaster in the field service division of a computer manufacturer that sold service contracts to computer users. To forecast demand and support supply planning, we developed a P-of-W model to forecast the installed base of computers on service contracts. Similarly, businesses that offer post-sales support services, such as extended warranties on industrial and consumer durable goods, could do the same.

Not just contract businesses can benefit from the P-of-W forecast model, however. Sales of service parts, accessories, and consumables (such as printer ink cartridges) in support of durable-goods use, as well as the sales of Maintenance, Repair and Operations (MRO) goods also are driven by the size of an installed base.

The Pot-of-Water Model

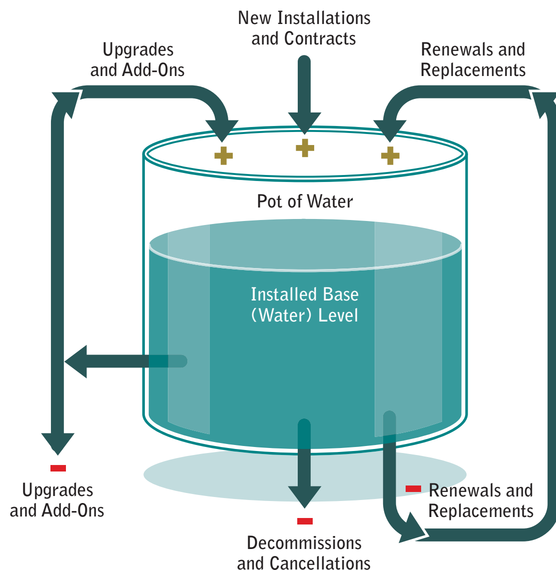
The P-of-W model is a cause-effect forecasting model in which the "effect" is customer demand for supply, while the "cause" is the size of the installed base of customers. This type of model is useful when it is easier to intermediately forecast the cause than it is to directly forecast the effect. For example, to more accurately forecast diaper sales, a P-of-W model would project the number of babies in diapers, and then use it to forecast diaper sales.

Exhibit 1 depicts the P-of-W model as a pot with the water level representing the size of an installed base. Over time, the level depends on four types of flows. Each is described below:

1. *New Installations and Contracts:* These represent users, products, or contracts that are new to an installed base as well as customers

EXHIBIT 1

The Pot-of-Water (P-of-W) Forecast Model



who have not previously done business with a company. All of these obviously add to the level of the installed base.

2. *Upgrades and Add-ons:* These flows add or decrease the size of an installed base. They represent existing contracts that have changed the services being purchased. Upgrades could be customers that have scaled up their levels of service as well as those that have scaled down their services (thereby resulting in a "negative" upgrade). They could also be sites that have changed the configuration of products being serviced—for example, when accessory and peripheral add-ons are put onto service or taken off service (thereby resulting in a "negative" add-on).

3. *Renewals and Replacements:* These represent existing contracts that have been renewed after expiring. They might result in a net addition or subtraction from an installed base depending on the size of the renewals. Replacements represent customers that have replaced the products being serviced with a different configuration (for example, when a new truck or piece of equipment is bought to replace an older one).

4. *Decommissions and Cancellations:* These represent contract cancellations for a variety of reasons, such as moving to a competitor's service and discontinuing the use of products being serviced. Manufacturing and sorting equipment lost in a fire, for example, would result in the decommission of what was being serviced under an MRO contract. These flows represent decrements to an installed base.

Looked at another way, the flows described above represent streams flowing into the pot and leaking out of it. The size of the installed base increases if the former outweighs the latter. The opposite holds true when the leaks exceed the inflows.

Installed Base Forecasting

Forecasting an installed base requires estimating each of the four flows and using them to forecast the base over time, beginning with a starting base. The forecasts might be in terms of years, months, or weeks.

To illustrate, here is how we used the model in the field service division I mentioned earlier. We constantly tracked and monitored the size and changes to our contract base of computer sites under contract. We would start by estimating future monthly flows in terms of new contracts, upgrades (involving changes to the configuration of equipment under contract), contract renewals, and cancelled contracts. We then applied these to the first month by adding them into the starting contract base (i.e., last month's ending base) to estimate the first month's ending base. This then became the starting base of the second month. Next we applied the flows to the second month and sequentially did this for all succeeding months over the planning horizon.

Supply Planning

Installed base forecasts and associated flows are useful for estimating the supply needed to support customers, such as for their service part needs. For example, we estimated the demand for service parts using the bills-of-material (BOMs) for equipment at contract sites along with part failure rates. Similarly, consumables, accessories, and MRO product sales for other companies could be forecast using the estimated average sales rates of each operational piece of equipment. In addition, upgrades such as accessory and peripheral add-ons can be forecast using estimated sale rates for each installation site.

Supply planning driven by P-of-W installed base forecasts will often provide more accurate plans than can be attained through traditional time-series forecasting methods. The reason is that traditional approaches extrapolate historical demand patterns to forecast future needs. If an installed base is stable, they work reasonably well. However, if a customer base is building rapidly (such as during the early stages of a new product) or is at an inflection point (such as when a product's sales start to rapidly take a turn for the worse), extrapolating needs using historical patterns is misleading.

The takeaway: if you are doing planning for the supply needs of an installed base, you may want to try using a P-of-W model to help you develop more accurate plans.

GLOBAL LiNKS

BY PATRICK BURNSON

Trans-Pacific Partnership: A New Breed of Trade Pact

Patrick Burnson is the executive editor at *Supply Chain Management Review*. He welcomes comments on his columns at pburnson@ehpub.com

Although U.S. exports to Asia have been ramping up as of late, our nation's manufacturers are continuing to lose market share. Supply chain industry analysts note that Asian countries have negotiated more than 160 trade agreements among themselves, while the United States has signed only three with countries in that region (Singapore, Australia, and most recently—South Korea).

The Trans-Pacific Partnership (TPP) Agreement currently under negotiation by nine countries may alter this scenario, however. Australia, New Zealand, Chile, Peru, Singapore, Malaysia, Vietnam, Brunei, and the U.S. are seeking to create a trade agreement that could become a model within the Asia-Pacific region.

If successful, even more new members may be added. In particular, Mexico, Canada, and Japan are likely to seek entry, too, with many trade analysts expecting China to even be an eventual member. The agreement is open to accession "on terms to be agreed among the parties, by any APEC (Asia Pacific Economic Council) economy or other state."

Supply chain implications are obvious, especially in this era of global business and cross enterprise collaboration. During the Supply Chain Council's annual conference held earlier this year, there was much talk about developments in the digital economy such as cloud computing, trade issues related to green growth, and appropriate approaches to ensuring a pro-competitive business environment.

The TPP is creating a framework to address just such concerns. The areas of negotiations include: tariffs and other barriers to trade in goods, services, and investments; competition; customs rules; capacity building; e-commerce; environment; government procurement; intellectual property; labor; sanitary and phytosanitary standards; technical barriers to trade; and telecommunications.

New Global Precedent

According to the TPP ministers, the following features will define this historic agreement and set a new standard for trade agreements in the future:

- *Full Market Exposure.* The goal of the TPP is to provide comprehensive, duty-free access to goods markets and to simultaneously lift restrictions on services.
- *Regional Cooperation.* The TPP participants plan to construct a fully regional agreement that facilitates trade and the development of production and supply chains among members. The ministers said the TPP will be the first trade agreement to include commitments addressing issues related to the "holistic" development of regional production and supply chains, including issues related to connectivity, customs cooperation and standards.
- *New Trade Challenges.* New challenges that have emerged in global trade will be considered as part of the TPP negotiations. These include developments in the digital economy such as cloud computing, green growth, and appropriate approaches to ensuring a pro-competitive business environment.
- *Living Agreement.* Finally, negotiators are "establishing structure, institutions, and processes that allow the agreement to evolve in response to developments in trade, technology or other emerging issues and challenges."

The TPP is not without its critics, however. Many fringe political action groups accuse the Office of the United States Trade Representative (USTR) of keeping the public in the dark while being influenced by hundreds of corporate lobbyists who have exclusive access to the details of the negotiations. Conspiracy theorists also allege that leaked documents support abuse by pharmaceutical corporations pushing to undermine citizen access to affordable medicine.

For obvious reasons, our two hemispheric

partners, Canada and Mexico, also have indicated their intent to begin discussions on joining the TPP this year. The U.S. welcomed these countries' interest in the agreement but cautioned that they must be willing to comply with its "high standards for liberalizing trade." Observers note that these three NAFTA economies are highly protective of specific domestic industries and that the impact of the TPP could be substantially reduced if they seek to perpetuate those protections in a final agreement.

While meeting with President Obama in Washington recently, Mexican President Felipe Calderon said that transparency is "inherent in the process," because each of the participating countries has its own "idiosyncrasies." He added that certain industries that have in the past been protected—along with certain practices that may be unique to that country—may end up creating business disadvantages for some TPP members.

TPP countries have agreed on most of the core elements of the cross-border services text of the agreement, providing the basis for securing fair, open, and transparent markets for services trade, including services supplied electronically and by SMEs (small and medium enterprises), while preserving the right of governments to regulate in the public interest. Participants are negotiating on a "negative list" basis, which presumes comprehensive coverage but allows countries to negotiate specific exceptions to commitments in specific service sectors.

Negotiators also have reached agreement on key elements of the customs text as well as the fundamental importance of establishing customs procedures that are predictable, transparent, and expedite and facilitate trade. The text will ensure that goods are released from customs control as quickly as possible while preserving the ability of customs authorities to strictly enforce customs laws and regulations. TPP participants all see the importance of close cooperation between authorities to ensure the effective implementation and operation of the agreement as well as other customs matters.

The leaders for the nine current members have publicly addressed these concerns, vowing to support trade transparency once the agreement is reached by the end of this year. No firm deadline has been determined for the TPP to become reality, but trade analysts concur that time is of the essence.

Why Asia Matters

The Asia-Pacific region is a key driver of global economic growth, representing nearly 60 percent of global GDP and roughly 50 percent of international trade.

According to the World Bank, the average GDP growth rate in the region's rapidly growing and dynamic countries was 5.3 percent last year, compared with the world average of 3.8 percent. Furthermore, over the past two decades Asia-Pacific goods trade has increased by 300 percent, while global investment in the region has increased by over 400 percent.

Finally, U.S. supply chain executives hope that the TPP will squarely address new cross-cutting issues not previously included in trade agreements. Ideally, regulatory systems of TPP countries will be more compatible, enabling even small- to medium-size U.S. businesses to operate more seamlessly in Asia Pacific markets. One happy consequence of such a development might mean more to the average American, too, namely job creation.

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TALeNT STRATeGIES

Managing the Expat Talent Option

By Doug Cooper and Jim Rice

Doug Cooper (doug@bycooper.com) recently left his position as SCM Business Development Manager, Wallenius Wilhelmsen Logistics, in Oslo, Norway, and is now a U.S.-based SCM business consultant. Jim Rice (jrice@mit.edu) is Deputy Director of the MIT Center for Transportation & Logistics.

With increasing focus on supply chain performance, the recruiting, hiring, and retention of logistics and SC talent is becoming a key differentiator for companies competing in global markets.

But as companies have expanded internationally, the demand for supply chain and logistics talent has also become international in scope. As a result, multinational companies with sources and markets on opposite ends of the earth face a significant staffing challenge: Finding the talent to support current and future growth across countries.

One traditional source for international competencies is expatriate (expat) relocation. But moving an individual and his or her family from their homeland to a foreign land seems like a drastic measure just to meet a job requirement. Why do companies and individuals take on this additional complexity and risk, and how can they ensure that these assignments are successful?

Why Expat Assignments?

Using expats to fill key positions in other countries is a well-established practice. And in many ways the rationale is the same in the SCM function as it is in other disciplines. The main reasons are summarized below.

• **Supply and Demand Mismatch.** The demand for experienced SC professionals far exceeds the supply, and expat appointments widen the field for companies in need of talent.

• **Global Supply Chains Call for Global Experts.** As businesses have grown globally, SC professionals need to become knowledgeable about industrial markets, logistics challenges, local resources, and labor issues in multiple countries. One of the most effective ways to gain this knowledge is by living and operating in different countries.

• **Ground Level View of Talent.** When the growth rate of globalized businesses outpaces the availability of supply chain talent in distant endpoints, companies can find it difficult to effectively evaluate and access local talent even when they have a presence in these places. Having an expat on the ground deepens the understanding of the talent available locally while building trust and strengthening the overall supply-demand relationship.

• **Direct Line Operation and Control of Local Activities.** Whether it is to protect investments as a minority shareholder or to ensure that local operations follow global processes, having someone on the ground day-in and day-out helps provide a more useful and accurate assessment of the business than periodic audits. On-site practitioners also bridge the gap between local practices and the standardized processes and procedures that companies follow globally.

In combination, these reasons make a convincing case for using expats as a core resource in global supply chains. Finding, training, and keeping them involve an entirely separate set of challenges.

Expat Challenges

Relocation is said to be one of life's most stressful experiences. Challenges such as language barriers, drastic climate shifts, and other significant lifestyle changes can push the emotional tension to an extreme level. Moreover, these tensions can increases exponentially when other members of the family are involved in the transition.

Beyond these pressures, there are several challenges that employers need to understand in order to later identify ways to deal with expat development and retention. For starters, the expat is often "out-of-sight and out-of-mind" back at the headquarters or home office. Once individuals leave their home base they can drop off their unit's radar screen. As a result, they may lose their place in line for job opportunities to others who are more visible to home-based decision makers.

Also, for many expats the assignment blurs

the line between work and home. Once work visas, tax support, and housing are included as part of a work contract, the expat's personal life is inseparable from his or her work life. This can have positive and negative effects. The assignment strengthens the employee-employer bond but also creates a dependency, which can intensify if spousal income opportunities are limited.

Further, even with a salary increase, a favorable cost of living adjustment, and eliminating a housing payment in the home country, the financial benefits of a move abroad can erode quickly due to unplanned costs, such as increased expenses for trips home, currency fluctuations, and unfamiliarity with the local environment.

Leveraging the expat's increased expertise back at the home office also poses a significant challenge. Expats typically go through a very high rate of personal and professional development while abroad that often surpasses the experience of their peers back home. They may have had much more responsibility than their peers, for example, and find that the breadth of activities in the home office is much narrower than what they have become used to.

Mitigating Strategies

The common thread in all of these challenges is uncertainty. The better both companies and individuals manage the uncertainty of the initial move and transition back to the home base, the more successful the experience will be for all involved. The following are some suggestions to help mitigate the downsides and leverage the potential of expat assignments. These measures are relevant for both the individual expat and his or her employer.

1. Career scenario planning and what's next: Before accepting the foreign assignment, discuss potential positions that might be available upon completion of the new job. Create scenarios based on these jobs and identify important trigger dates and actions throughout the contract period. Active dialogues throughout the expatriate assignment will help determine what is the best position from both employee and employer perspectives. Think about "what's next" after that first assignment. If the individual will eventually return to the home office, identify how that will happen from the start. Waiting until it's time to move to do this process is too late.

2. What-if contract clauses: The assignment contract needs to be more than just a job description and a financial package. Ensure that the exception situations are covered by asking "what-if" questions. What if the currency fluctuates dramatically? What if my family needs to return home? What if I leave the company? Asking difficult questions may make the negotiation uncomfortable, but it is less stressful before the assignment begins than later when such an emergency might arise.

3. Spousal support: The ease with which spouses can find employment is often overstated by human resources. It is difficult enough to find a good job in one's home country, let alone in a work environment where a person has no experience and cultural knowledge. Companies can offer additional compensation as part of the contract, but this addresses only the financial risk. An individual used to contributing and being productive will have difficulty adjusting to a non-work life. One suggestion is for multinational companies in host cities to network with other companies to provide jobs to spouses of expatriates.

Recognizing the issues of expat assignments can help increase retention and improve business performance.

4. Key tether: The expat needs a key "tether" or connection back to the home organization. This may be a senior operating executive charged with oversight and a human resources person. The tether and expat need to find regular ways to stay connected not only on developments in the expat's role but also at the home base, scanning future ways to re-integrate the expat back into the business.

5. Shorter expat assignments: Some organizations use very short expat assignments to avoid some of the challenges described above. Shorter job assignments can deliver many of the personnel development benefits, local presence, and control without the extreme challenges of relocating and repatriating.

Manage for Success

Expat assignments have been around for a long time. Yet they merit special attention—particularly through a SCM lens—at a time when companies are expanding in remote locations that are very different culturally and socially from their home bases. This talent management practice can be very effective, but if the issues we have described are not addressed, investments in these appointments will not be fully realized—either by individuals or companies involved.

Recognizing the issues and identifying and adopting some of the leveraging and mitigation strategies we have covered can help increase retention and improve business performance. Given the personnel challenges that the supply chain community is grappling with, expat assignments are often the best way to develop and source the talent required to grow and compete globally.

The Competitive Potential *of* Supply Management

By Robert M. Monczka and Kenneth J. Petersen

Supply management can be a powerful competitive weapon—if the strategy driving that activity is closely and continuously aligned with the business strategy. Yet new research suggests that the necessary alignment is often lacking. This article offers a process for identifying and implementing the supply management strategies that hold the best potential for competitive advantage. What's involved here is a transformational supply management change.

Firms around the world are developing and adapting business strategy in order to meet an ever-changing global marketplace. These changing business strategies are frequently driven by downward price pressure, more complicated global supply chains, increasing global competition, heightened customer value expectations, changing population demographics, increasing demand for environmentally safe products, rapidly changing technology, and growing stakeholder demands.

In this dynamic environment, supply management strategies must align with and support rapidly changing business strategy. In fact, when this alignment is lacking, supply management simply cannot properly support the business. For example, supply management may focus on delivering business value through the negotiation of improved pricing, when the business actually needs insight into suppliers' process and technology innovation. In this case, the supplier will certainly understand that they are primarily competing on price and then appropriately choose to withhold their valuable insight into process and technology innovation.

For most organizations, the close and continuing alignment of supply management strategies with business strategy represents a transformational supply management change. In this article, we suggest a process to help supply management professionals

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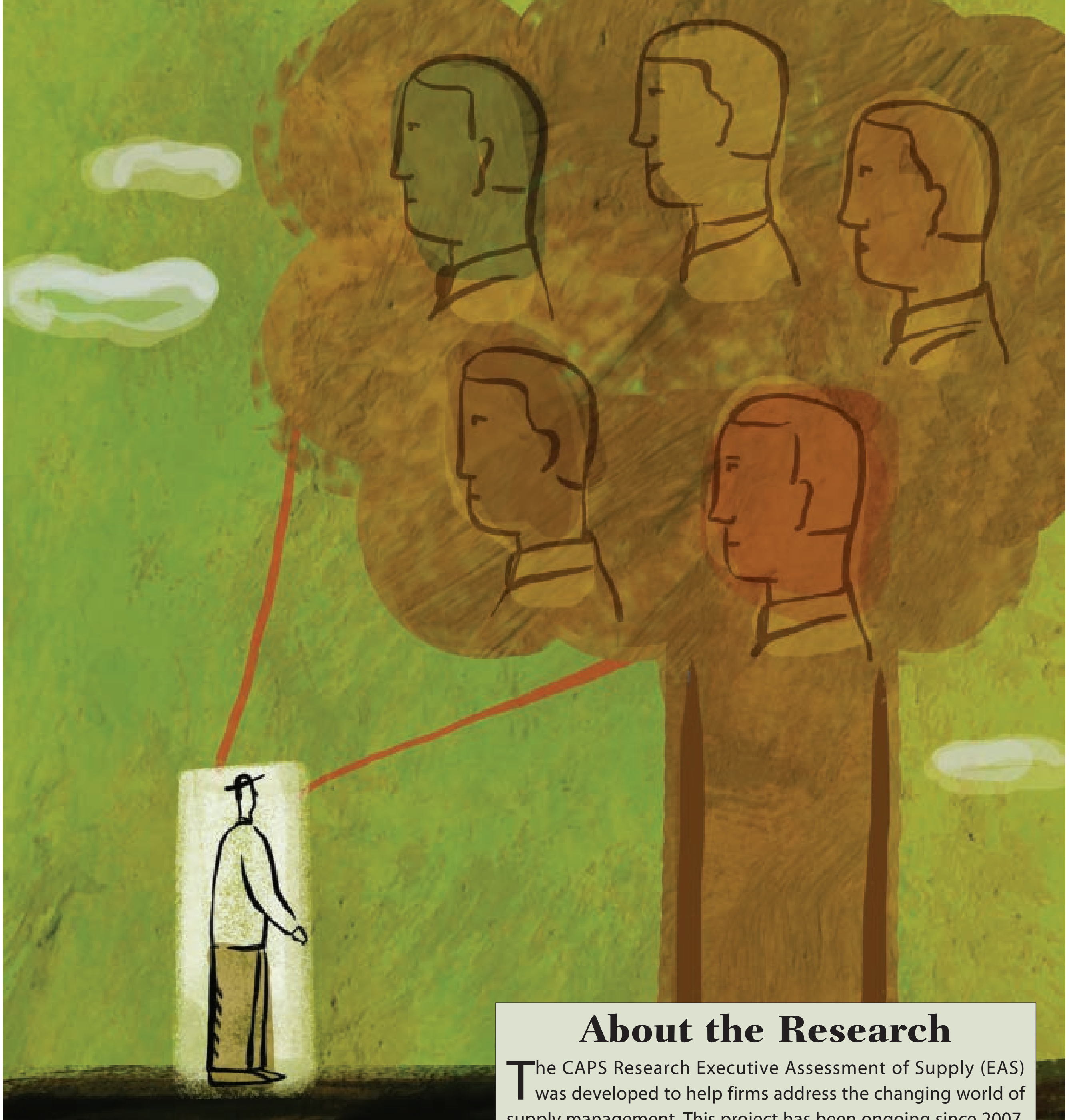


undertake this transformational change in a fast and effective way.

Our discussion is based on the most recent CAPS Research Executive Assessment of Supply (EAS). (For more on this research, see accompanying sidebar.) We describe the current state of supply management, suggest a future state of supply management strategy, point to those opportunities for strategy development and improvement, and then outline a process for achieving the necessary supply management transformation. Our goal is to give forward-looking supply executives a view of where they might most effectively apply resources in order to close gaps—and in so doing

About the Research

The CAPS Research Executive Assessment of Supply (EAS) was developed to help firms address the changing world of supply management. This project has been ongoing since 2007, with the most recent survey conducted in 2011. The goal of this research is to determine what importance organizations place on critical supply strategies, their level of implementation, and the performance resulting from these strategies. Data for the most recent study were collected from 119 supply organizations related to 22 supply strategies and performance results. Respondents were primarily from the United States and represented 25 different industries, which we have broadly classified into the broader sectors of discrete manufacturing (33), process manufacturing (42), and service (44).

The 2011 Executive Assessment of Supply is the third in a series; prior study results were published in 2007 and 2009. The 2011 EAS report and complete description of the strategy areas can be found at www.capsresearch.org.

better support business strategy and contribute to their companies' competitiveness.

Current State of Supply Strategy

Supply management executives participating in the EAS study were asked to rate each of 22 supply strategy areas in terms of both their importance and implementation. (These strategy areas are listed in the appendix to this article.) Overall, respondents reported that the importance of these supply strategies was much greater than the implementation of them (see Exhibit 1). The rating of importance was considered to be "high/critical" (that is, operational necessity, required for operational effectiveness, necessary to gain market leadership, achieves competitive viability—a necessary consideration to compete). The rating of strategy implementation, by contrast, ranged from "moderate" to somewhat less than "extensive." This difference between strategy importance and strategy implementation denotes a substantial gap and a corresponding opportunity for ongoing and focused supply strategy development and implementation.

From Exhibit 1, we can see that the range across the 22 strategy areas is quite large in terms of how extensively the firms have implemented these strategies. Similarly, the difference between average level of strategy importance and strategy implementation is sizable. That gap has existed since our first EAS study in 2007. In fact, the results indicate some, but not dramatic, improvement—and little change since the 2009 study, as shown below:

	2007	2009	2011
Implementation	5.2	5.7	5.5
Gap	2.4	1.9	2.0

Beyond this overall view of supply strategy and implementation, let's look more deeply into each of the 22 strategy areas examined in this 2011 research. Exhibit 2 shows the five most and five least important strategy areas and the five most and least implemented strategy areas. We can clearly see that the strategies considered to be most important also tend to be the most frequently implemented. However, attention also needs to be paid to the least frequently implemented and important supply strategies, which likely could be of significant importance to the firm's future competitive success.

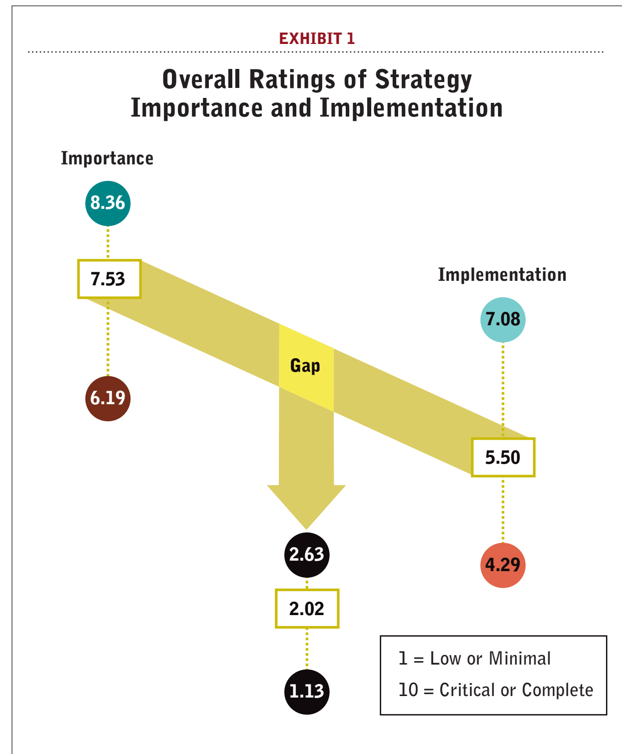
Thinking about supply management strategies in general, we believe that they may be appropriately organized into three separate groups:

• "Core strategies," which may be executed nearly entirely within the supply management function.

• "Extended-core strategies," which require collaboration with other business functions within the firm.

EXHIBIT 1

Overall Ratings of Strategy Importance and Implementation



• "Integrative strategies," which require significant integration both within the firm and with value chain partners (that is, the customer and/or supplier networks).

Interestingly, the five most important and widely implemented strategies tend to focus on both core and extended-core areas. Receiving relatively less attention are the more advanced integrative supply management strategies (for example, integrating suppliers into new product/service development, standardizing environmentally sustainable supply chains, collaborative buyer/supplier development). Further, these integrative strategies are frequently lower rated in terms of both importance and implementation. Notably, this finding does not appear to necessarily align well with overall business strategy, which is increasingly focused on customer segmentation, innovation and risk management, complexity reduction, sustainability, collaboration, customer-focused supply chains, and globalization.

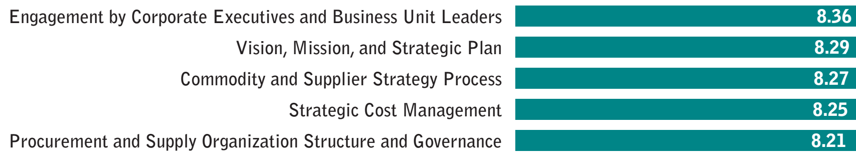
We also looked closely for trends within our broad industry classifications—discrete manufacturing, process manufacturing, and service industries. In the end, the overall findings apply equally well to each of these broad industry classifications.

For those strategies rated most important, where do the greatest implementation opportunities exist? Exhibit 3 attempts to answer this question. As the graphic shows, the biggest gaps or largest opportunities (implementation vs. importance) exist across all of the strategy areas including core, extended-core, and

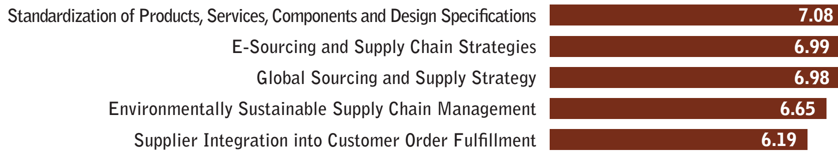
EXHIBIT 2

Five Least and Most Important/Implemented Supply Strategies

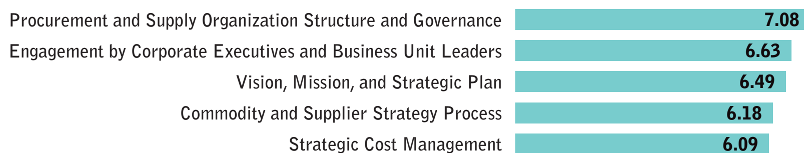
Five Most Important Strategy Areas (Average Rating: 8.28)



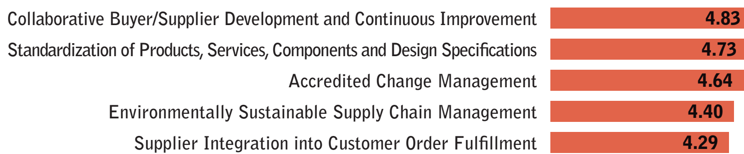
Five Least Important Strategy Areas (Average Rating: 6.78)



Five Most Implemented Strategy Areas (Average Rating: 6.49)



Five Least Implemented Strategy Areas (Average Rating: 4.58)



1 = Low or Minimal   10 = Critical or Complete

and by strategy area. Low levels of overall supply strategy implementation are typically coupled with a lack of a transformation emphasis and too few resources. This could prove costly to firms over time—particularly in light of the reported achievements of the organizations that have achieved the deepest level of implementation across all supply management strategies. In fact, considering this difference, the "most implemented" firm achieved an overall implementation rating (across all 22 supply strategy areas) of 9.6/10, while the "least implemented" firm had an overall implementation rating of 4.3. That's a gap of 5.3 between the most and least implemented firm. As the findings show, the span between most and least implemented firms is substantial—and represents a integrative. For instance, we can see that strategic cost management, total cost of ownership, measurement and evaluation, supplier assessment and measurement, supply base strategies, human resources, world-class quality and commodity strategies provide the greatest opportunity. Several are relatively more advanced and complex and require significant integration. Some strategies are also more difficult to implement because they generally require cross-functional engagement and support.

At a minimum, firms should consider how they might accelerate their supply transformation efforts in the areas portrayed in Exhibit 3 to achieve key supply strategy goals. The choice of which strategies to transform first will depend on the degree to which each supports business strategy, the current level of implementation, and the resulting opportunity for value creation through deeper implementation.

Comparing Firms on Implementation

When comparing the firms that have the greatest and least degree of implementation across all supply management strategies, we found large differences—both overall

EXHIBIT 3

Greatest Implementation Opportunities

significant opportunity for firms that are lagging in supply strategy implementation.

Importantly, substantial opportunities exist for even the most implemented firms as well. Exhibit 4 shows the six supply strategies that evidenced the largest strategy implementation gaps between the 25 firms with the highest implementation levels and the 25 firms with the lowest. The exhibit reinforces the important point that more mature supply management organizations have had much better success with implementing the more integrated supply management strategies—for example, total cost of ownership and collaborative buyer/seller development. In fact, the difference between the most and least implemented firms is stark in comparison.

Supply strategies that are generally rated as less important also tend to be harder to implement. It's certainly the case that companies generally focus on relatively easy-to-implement supply management strategies that provide at least some benefits. In addition, some firms' relative importance rating may be lower for certain strategies because they have already implemented them and are now prioritizing and implementing new and potentially more integrated supply management strategies.

It is these relatively less-implemented strategies that require integration with and collaboration across functions, and often also with supply chain partners such as customers and suppliers. These strategies may offer the greatest contribution to supply value creation over the coming years. For example, e-supply systems are becoming a critical enabler for more effective supply risk management and many other applications and, as such, will require an intensive and ongoing focus. In fact, without appropriate technology-enabled processes to provide important data (for example, predictive analytics) and a means to communicate and collaborate within and across organizations, supply value creation may be limited. Innovation, accelerated change management, and complexity reduction also need to be integral parts of supply transformation efforts. The same holds true for talent enhancement.

Sixteen Companies: How Implementation Has Changed Over Time

Recall that this Executive Assessment of Supply was conducted in 2007, 2009, and most recently in 2011. Over this period, we have tracked the performance of the 16 companies that have participated in all three iterations. We did so in order to determine the validity of our assumption that firms that were regularly participating in the EAS research might be on a steeper implementation path than the average company.

While the performance of these 16 firms suggests that there is still room for improvement when it comes to implementing the supply strategies critical to their overall competitiveness, they have achieved considerable progress since 2007.

As an example, and undoubtedly the result of a diligent focus on business strategy-aligned transformational change, these 16 firms significantly closed the implementation/importance gap in the nine strategies listed below (the numbers in parenthesis represent the gap closure between strategy importance and strategy implementation from 2007):

- Procurement & Supply Organization Structure & Governance (1.21)
- Total Cost of Ownership (.82)
- Supplier Assessment, Measurement & Communications (.76)
- Engagement by Corporate Executives & Business Unit Leaders (.65)
- Structuring and Maintaining the Supply Base (.60)
- Establishing World-Class Supplier Quality (.57)
- Vision, Mission and the Strategic Plan (.55)
- Strategic Supplier Alliances (.54)
- Supplier Integration into New Product/Process/Service Development (.51)

Leadership from company and supply management executives, coupled with a cross-functional and cross-enterprise value chain focus, were required to close these gaps. These strategies are generally more complex to implement and require significant leadership and investment; however, their implementation may position the firm for greatly improved return on investment.

For all 22 supply strategies, the 16 firms consistently

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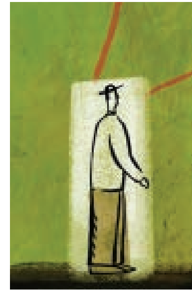

increased implementation between 2007 and 2011, with some dips in 2009, presumably due to the severe recession. Importance of the strategies also increased, but less consistently. Supplier Integration into Customer Order Fulfillment; Cross-Functional/-Location Teaming; Standardization of Products, Services, Components & Design Specifications; and e-Sourcing and Supply Chain Strategies saw minor decreases in their importance rating, which likely reflects the 2009 recession-related cost cutting.

Overall, both strategy implementation and importance increased for those 16 firms between 2007 and 2011. On average, implementation increased by .93 and importance by .28. In addition, the overall gap between Supply Strategy Importance and Implementation dropped from 2.41 in 2007 to 1.66 in 2011—a significant improvement of .75 at these 16 companies. This reduction almost doubled the average gap reduction of .4 across all firms. The message is clear: a closer alignment of supply management strategies with business strategies must be an ongoing effort if true supply management transformation is to be achieved.

Supply Strategy Focus Looking Forward

In completing the survey, participants were asked to identify three emerging supply strategies that would be most critical to improving their firm's competitive performance over the next three to five years. We also asked each firm to describe the major drivers of these emerging strategies.

Analysis of their responses showed not only a clear focus on the core and extended-core supply strategies, but also definite movement toward the more integrative and complex supply strategies. The following represent some of the more interesting emerging leadership and cross-functional, cross-enterprise integrative strategies described by the respondents. (Industry of respondent shown in parentheses.)

Executive Supply Management Leadership (Diversified Food and Beverage). "As a company, we have to do a significantly better job of defining what we need in our executives and executive team, and develop a rigorous process of recruiting and retaining true world-class executives to lead and manage this company. 'All Stars' at each position is an absolute necessity as well as collaborative teamwork in the best sense of the term. We are currently not where we need to be for the long haul."

Supply Chain Talent (Industrial Manufacturing). "Establishing reliable talent pipelines, especially in emerging market regions, and moving talent across businesses to create leaders with a broader view of the company. This is important because we are constantly being asked to do more with less and rapid business growth is creating the need for a deeper bench of talent."

Supply Strategy For New Market Development (Automotive Manufacturing). "Our market growth,

In today's global dynamic environment, supply management strategies must align with and support rapidly changing business strategy.

and thus the manufacturing footprint associated, is going to be coming a lot from China and India; thus, the need to develop a local competitive supply base to serve those markets. This base will also be used for other markets if the total landed cost shows a benefit for that. For this strategic driver, we will rely heavily on one of our main assets—a team of supplier quality and development specialists with a heavy presence in China and India whose task is to participate in the screening of new suppliers and develop them."

Early Supplier Involvement in New Product Development (Industrial Manufacturing). "Involving suppliers early in the new product development process is critical and driven by a need for innovation and speed to innovation. It is also driven by customer expectations about concept-customer cycle time (reduction) and delivered product price."

Integrated Supply Strategy (Industrial Manufacturing). "Opportunity to reduce supply risk for key raw materials, and improve economics through strategic sourcing arrangements such as licensing technology, JVs, M&A, and capital projects, in addition to cross-functional purchasing approaches for qualifying new sources."

Supplier Relationship/Performance Management (Pharmaceutical). "Increased focus on supplier relationship management and supplier performance measurement driven by revenue and profit erosion due to generic competition, pipeline challenges, political environment, worldwide demographics, etc., and resultant focus on cost reductions, supplier innovation and total value. We will partner with suppliers who successfully collaborate to deliver against all facets of AQSCI (assurance of supply, quality, service, cost, innovation), year-on-year cost reductions and total value."

Environmental and Social Sustainability and Governance (Semiconductor Manufacturing). "We need improved focus on environmental and social sustainability as driven by governmental, social and non-governmental pressures that challenge the preservation of our brand name. Further, regulatory compliance

requires process, systems and behavioral changes across the corporation, requiring investment and time. Finally, we need to separate these two areas (brand/image vs. regulatory compliance) so that we change our sourcing and procurement strategies such that they address both brand and image, and not just regulatory compliance."

Innovation through Supplier Relationship Management (Chemical). "Improving our ability to draw innovation from our supply base and improving the gains achieved through effective supplier relationship management."

Simplification and Standardization (Diversified Foods and Beverages). "Our company developed over time through many acquisitions, each with their own variations on product offerings to their customers. The result is that we have too many variations, which drives inefficiencies in our plants and with transportation and delivery. We must reduce our complexity by a factor of 10 in the next few years and standardize."

Supply Base Diversification and Competitiveness (Metals and Mining). "We will focus on diversifying our supply base to include suppliers from different countries and regions, while at the same time restricting sole sourcing. This will minimize our risk, and we will have a wider supply base to utilize moving forward."

Collaboration (Semiconductor Manufacturing). "Supplier collaboration on product technology—increased advanced technology content in products, leading to increased leverage of suppliers' advanced technology and capability."

Recommendations for Future Success

A very important finding of this study is that supply management professionals have worked hard to implement core and extended-core supply management strategies, but have not focused to the same degree on implementing the integrated strategies that are likely to drive fundamental business value moving forward.

Although supply management is becoming more strategic at companies worldwide, implementation of critical supply strategies that are closely connected to enterprise-level strategic importance is still lagging. In fact, it is considerably short of the maximum potential. Companies need to continue to further enhance and ensure a high level of implementation and effectiveness of such core strategies as purchase category/supplier strategy development, structuring and maintaining the supply base, procurement and supply organizational structure and governance, strategic cost management, and talent acquisition and development.

Our research suggests that greater emphasis needs to be placed on the extended core and integrative supply strategies required for supply and supplier networks to become an integral part of customer-focused value chains. Some of these supply strategies include:

- Collaborative buyer/supplier development and continuous improvement—for innovation, proactive risk management and customer solutions development.
- Standardization of products, services, components, and design specifications.
- Accelerated change management.
- Environmentally sustainable supply chain management.
- Supplier integration into new product/service development for innovation and customer order fulfillment.
- Total cost of ownership.

Customer-focused value chains will require tighter integration between a company's functions and its external customers and suppliers. This integration will be achieved through a clearly articulated vision of value chain strategy and leadership, in combination with performance metrics that properly assess customer satisfaction with value provided and supply and supplier contributions. Supply management strategies that can make major contributions to company performance must be implemented on a worldwide basis, not just close to primary U.S. and European markets.

In implementing these far-reaching strategies, companies truly embark on a supply transformational journey—one that can be long and fraught with interruptions. However, our ongoing research and prior experience suggests that it can be successful if certain key elements are in place, including:

- Clearly articulated goals that are important to the business.
- Transformation priorities.
- The resources and capabilities to implement significant change.
- A focused transformation process.
- Leadership action to drive supply transformation.

Below we elaborate on these five elements that we believe are critical to the success of the supply management transformation journey.

Establish Clearly Articulated Goals
It is important to identify and clearly articulate the value to be gained—i.e., the goals—from a supply transformation realized through implementation of the supply management initiatives. Those goals may vary. They could, for example, focus on various ways to achieve cost reduction—through negotiations, price reductions based on raw material price decreases, cost reduction ideas from suppliers, cost modeling, best country sourcing, and so forth. Some firms may set a longer term objective of obtaining innovations from their key suppliers. Another

longer-term goal would be to achieve integration among supply chain members.

In implementing any of these initiatives, capital, people and time investments may be required. Increasingly, firms are requiring that the return on investment from such initiatives be comprehensively and accurately measured. For any transformation effort to succeed, the goals must be clearly articulated, expertly implemented, and closely measured. And importantly, information around these activities must be effectively communicated throughout the organization.

Set Transformation Priorities

Each of the 22 strategy areas described in this article should be carefully evaluated in terms of their business priority, which can differ greatly from firm to firm. Priorities will be established based on an organization's current state and potential short- and long-term benefits from executing the strategy.

Even though many firms are engaged in improving some or all of these strategies, our findings suggest that there are still substantial opportunities for implementation improvements. Each of the 22 strategies described in the Appendix should be prioritized for possible implementation focus based on anticipated results in light of costs and complexity to implement. Note that we previously described a set of strategies with very large implementation-importance gaps. Companies experiencing such gaps should consider these strategy areas as a top priority.

Ensure Resources and Capabilities

Firms undertaking supply transformations must ensure that they have the resources and capabilities to execute the initiative over time. Two major considerations here are the complexity of the strategy and the firm's implementation capability. Executive support is critical to ensure that the appropriate capabilities and resources are in place to support the future vision. Also required is a full and detailed project management approach in which objectives, responsibilities, timing, investment, and returns are shown.

Establish a Focused Transformation Process

Supply transformations will sometimes fail. To minimize this possibility and position the supply management initiatives for success, we recommend a process that centers on implementing a very targeted set of supply strategies on a limited basis. Our experience with firms is that attempting to implement multiple strategies all at once with grandiose promises will lead to failure. Focus is critical.

Leadership Action to Drive Supply Transformation

Supply management strategy is critical to the success of business competitiveness. Firms are being forced to change their business models and strategies in ways that require significant supply strategy transformations. Currently, we believe that these transformations are occurring too slowly. In response to this challenge, supply and executive leaders must commit to answering the following questions in a clear and concise manner—and taking appropriate action:

- What will be the role of your firm's supply management function and what supply strategies (core, extended-core, and integrative) will be required for your business to compete over the next few years?
- How will your firm's transformational process support effective and quick change?
- How can your firm ensure that its process for supply transformational change is continuous, a part of company culture, and is not a short-term effort with limited long-term value creation potential?

Appendix

Strategy Areas Measured

Core Strategies

Commodity & Supplier Strategy Process
Establishing World-Class Supplier Quality
Human Resource Development
Measurement and Evaluation
Procurement & Supply Organization Structure & Governance
Strategic Cost Management
Structuring & Maintaining the Supply Base
Supplier Assessment, Measurement & Communications
Vision, Mission and the Strategic Plan

Extended Core Strategies

Cross-Functional/-Location Teaming
Engagement by Corporate Executives & Business Unit Leaders
E-Sourcing & Supply Chain Strategies
Global Sourcing & Supply Strategy
Strategic Insourcing/Outsourcing
Strategic Supplier Alliances

Integrated Strategies

Accelerated Change Management
Collaborative Buyer/Supplier Development & Continuous Improvement for Innovation, Proactive Risk Management and Customer Solutions Development
Environmentally Sustainable Supply Chain Management
Standardization of Products, Services, Components & Design Specifications
Supplier Integration into Customer Order Fulfillment
Supplier Integration into New Product/Process/Service Development
Total Cost of Ownership

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SUPPLYCHAIN MANAGEMENT REVIEW

FEATURES

8 The Supply Chain Top 25: Leadership in Action
The 2011 rankings of the Top 25 supply chains from Gartner Inc. are in. They include repeat winners and some new entrants. Perhaps even more important than the actual rankings, says Gartner Research Director Debra Hofman, are the lessons that can be learned from analyzing the leaders. This year, six specific qualities stand out.

16 The Greening of Walmart's Supply Chain...Revisited
In 2007, *SCMR* ran an article on Walmart's sustainability program, focusing on eight specific initiatives being pursued. Four years later, the author of that original article, Erica Plambeck of Stanford, and colleague Lyn Denend revisit those initiatives to assess just how Walmart is doing on the sustainability front.

24 Achieving Flexibility in a Volatile World
A new global survey from PRTM confirms the importance of operational flexibility in supply chain success and identifies five levers that leaders employ to make it happen. The consultants report that the financial and performance advantages of improved flexibility can be profound. They outline five basic steps that companies can take to start realizing those benefits.

32 What's Your Mobility Index?
Mobile devices are everywhere these days. But what's the real potential of mobility in the key supply chain processes. And what's the best way to identify and tap into that potential? Sumantra Sengupta of EVM Partners says the first step in answering these questions is to carefully determine your "Mobility Index." This article tells how it's done.

40 The Case for Infrastructure Investment: Lessons from Medco and Staples
Smart investment in supply chain infrastructure—and in particular automated materials handling and distribution systems—can pay big dividends. Medco and Staples have proven that convincingly, as these case studies demonstrate. Their stories point to seven key takeaways that supply chains professionals in any business sector can learn from.

SPECIAL SUPPLEMENT
S50 EU Logistics: Meeting the New Challenges

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Creating ENTREPRENEURIAL SUPPLY CHAINS

By William B. Lee

*Dr. William B. Lee is a consultant and corporate educator in supply chain management. This article is based on his latest book, **Creating Entrepreneurial Supply Chains: A Guide to Innovation and Growth** (J. Ross Publishing, 2012). He can be reached at wbleephd@ymail.com.*

The notion that the elements of supply chains—from suppliers' suppliers to customers' customers—can be used in an entrepreneurial manner is a powerful one. We call this emerging concept entrepreneurial supply chains, and we believe that companies should aggressively implement and practice it.

But because it is a new concept, perhaps we need to set the stage to explain just what we mean.

What is an entrepreneur? An entrepreneur begins a business with fresh ideas that hold opportunity for profit and growth. The entrepreneur obtains resources, begins the venture, bears the risks, and reaps the payoff or suffers the loss. The business can be a start-up or a unit of an established venture. Further, entrepreneurial activities can be "replicative" or "innovative" in nature. The vast majority are in the replicative category because they reproduce or closely follow past successes. But even replicative entrepreneurial initiatives originated with innovative ideas. McDonald's and Starbucks are classic examples of replicative entrepreneurship, though they both began with innovative ideas.

Innovative entrepreneurial activities—and the leaders behind them—represent truly new ideas and leadership models. Steve Jobs is a perfect example. Jobs' brand of innovative entrepreneurship has not yet moved into the replicative arena. With his untimely death, only time will tell when or if that happens. For the purposes of our discussion, we include both the innovative and replicative types of entrepreneurial supply chains.

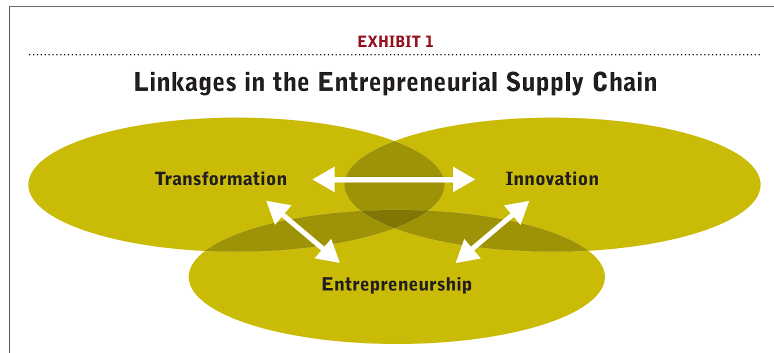
What are entrepreneurial supply chains? Entrepreneurial supply chains go beyond the traditional focus on cost, quality, and delivery to also embrace innovation and growth. Entrepreneurial supply chains connect customers' customers with suppliers' suppliers. They are designed to achieve growth in the enterprise by recognizing and responding to needs and opportunities that call for growth-focused responses. Note upfront, though, that moving from a traditional to an entrepreneurial supply chain is not always easy. It demands major shifts in mindsets.

Entrepreneurial supply chains typically follow one of three "paths" that can be described as follows:

1. Take existing products and services and move them to new customers, markets, and locations.

Entrepreneurs are widely known for their ability to conceive and generate innovative ideas that lead to business growth and profitability. Is there any reason why companies cannot apply the same entrepreneurial sprit to their supply chains? The author of a new book on that subject says no. Here's his recipe for creating entrepreneurial supply chains.

Photo by Dorling Kindersley



McDonald's and Starbucks have been pursuing this entrepreneurial supply chain strategy for years as they expanded all over the world. Their moves into hospitals, airports, and other types of locations, for example, not only allow them to capture new customers but also to serve regular customers in new settings.

2. Develop new products and services for existing customers and markets. Hybrid automobiles represent examples of these types of entrepreneurial supply chain moves. Who is better able to recognize needs and opportunities for new entrepreneurial products and services than supply chain people who interact with suppliers and customers on a daily basis?

3. Enter the "white space" of new products and services combined with new customers and markets. This is the most risky of the three paths. The boom in shale gas of the past few years has given energy companies the opportunity to develop new technologies for new customers and markets. To capitalize on the opportunity, they are transforming their supply chains accordingly.

Creating entrepreneurial supply chains to achieve innovation and growth almost always requires some type of transformation. Supply chain transformations are significant and fundamental improvements that have staying power beyond the initial results or the continued presence of the initiative's champion. To help ensure that needed staying power, culture and human behavioral challenges must be addressed and integrated into the transformation.

Why Create an Entrepreneurial Supply Chain?

Before delving into the "how" of creating entrepreneurial supply chains, let's first examine the "why." Entrepreneurial supply chains that result from fundamental transformation can contribute to and support innovative ideas for products and services that can drive growth across the entire enterprise. This notion is summarized at a high level in Exhibit 1. This graphic suggests that transformation drives both innovation and entrepreneurship and vice versa. All three elements need to work together. And when they do, the business results can be powerful, as discussed throughout this article.

True transformations fundamentally change the way an enterprise works, as described by the author and Michael Katzorke in the book *Leading Effective Supply Chain Transformations.*[1] Linking of plans up and down the supply chain and with other elements of the enterprise is fundamental to successful transformation. This applies to tactical as well as strategic plans. The term "supply chain" is all about linkage and integration. A successful supply chain transformation ensures that the vital linkages are fixed—from suppliers' suppliers to customers' customers.

Transformation is intended to make the enterprise both more innovative and more entrepreneurial. Innovative ideas tend to result from a network of interconnected individuals, groups, and activities. Steven Johnson, who has written an excellent book titled *Where Good Ideas Come from: The Natural History of Innovation* says that innovative ideas are not single things.[2] They usually are "swarms" of ideas—an interesting choice of terms that explains the concept very well.

The act of creation, Johnson says, is something that happens exclusively in the mind. Quoting from Johnson's book: "On a basic level, it is true that ideas happen inside minds, but those minds are invariably connected to external networks that shape the flow of information and inspiration out of which great ideas are fashioned…the most productive tool for generating good ideas remains a circle of humans at a table, talking shop." To illustrate, he uses the phrase "the adjacent possible," which we use when talking about existing products and services being moved into new customers and markets and about existing customers and markets being served with new products and services. Typically these are the types of ideas that initially are generated by people "talking shop."

As it relates to entrepreneurial supply chains, the transformation process encompasses several stages. Transformative changes need to occur through a combination of one-time and continuous improvement. In reality, change usually entails an accumulation of incremental and radical improvements—with some setbacks along the way. Supply chains almost always exhibit flat or erratic performance before the change. In fact, this is typically the catalyst that triggers the desire for a real step-change in performance. Transformation efforts, however, do not just happen overnight. It takes active management of the transformation process and related changes to keep the initiative on track, particularly as

the inevitable setbacks crop up. It also entails putting in place a continuous improvement capability after the transformation, so as not only to sustain the changes but also to improve on them.

To truly gauge whether a transformative supply chain initiative has been successful, it must be measured against three criteria:

- *How much* has supply chain performance improved?
- *How fast* have the changes occurred?
- *How sustainable* are the changes?
- How and where are opportunities likely to develop and how can we recognize them when they appear?

Entrepreneurs first consider the entire end-to-end supply chains in their search for entrepreneurial opportunities and needs. Next, they lay out how they can gain the benefits of their efforts. This thinking ultimately leads to deciding *what* to do, by *whom*, and in *what sequence*—namely, what should we do now?

What Should We Do Now?

Now to the "how" of building an entrepreneurial supply chain. Exhibit 2 gives a practical framework of what should be done and in what sequence. It's a fairly straightforward five-phase process that builds on a strategic vision. From that cornerstone vision, objectives are set, and an approach is crafted, implemented, and executed. From there, developments are monitored, performance is evaluated, and corrective actions taken. This whole process is revisited and revised in light of factors such as actual performance results, changing business conditions, emerging opportunities, and new ideas. This approach looks relatively simple in concept, yet it can be excruciatingly difficult in practice. To explain, let's briefly take these steps one at a time.

Phase 1: Develop a Strategic Vision. Said a little differently, we first need to decide to do an entrepreneurial supply chain. Or as one of Yogi Berra's well-known quotes goes: "You've got to be careful if you don't know where you're going, because you might not get there."

The strategic vision describes how the company anticipates becoming entrepreneurial using its supply chains. It lays out the strategic path that the company has chosen to improve its business, including the milestones along the way. Well-designed visions are unambiguous and unique to the company. They are not generic statements that could apply to any number of organizations. The real purpose of a vision statement is to give the organization a sense of where it is going.

Phase 2: Set Objectives. The objectives are performance targets for entrepreneurial supply chains. In setting objectives, many successful companies use the concept of SMART—i.e., objectives that are Specific, Measurable, Actionable, Relevant, and Time-bound.

A classic (but still useful even after more than 40 years) book on this subject is Paul Mali's *Management by Objectives*[3] (MBO), which has become part of the lexicon of management thought. He describes MBO in its simplest form as the "blending of individual plans and needs of managers toward a large-scale accomplishment within a specific period of time." This description suits our purposes in setting objectives for entrepreneurial supply chains. That is, we need to blend the plans and needs of individuals into large-scale ideas of entrepreneurial supply chains.

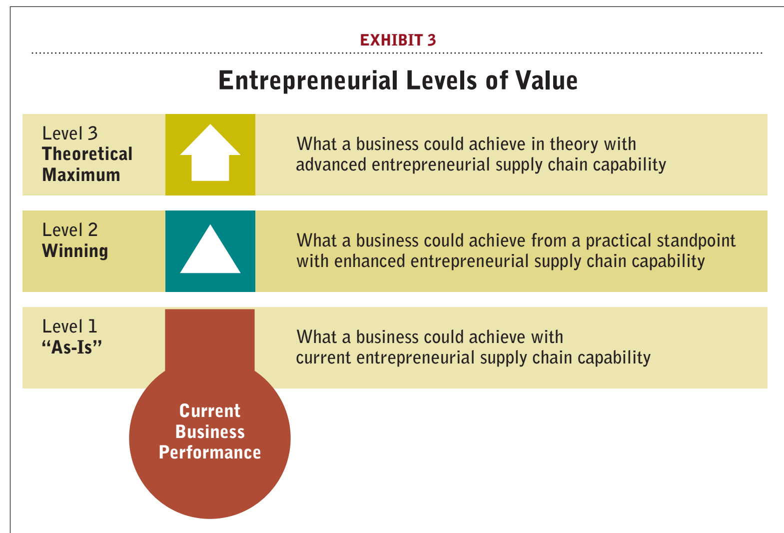
Phase 3: Determine the Approach. Determining the approach to entrepreneurial supply chains frequently concentrates on a group of "how to" questions. These include: *How to* choose the products and services, *how to* address customers' needs, *how to* do better than the competitors, and so forth. This is the essence of strategy—the pursuit of competitive advantage.

Phase 4: Implement and Execute. We've decided to *do* entrepreneurial supply chains, we've set our objectives, and we've determined our approach. Now comes the hard part, actually implementing and executing the plan. Clearly, in most cases this will involve doing things differently from how they've been done in the past. Someone once said that the definition of insanity is "doing the same things in the same ways and expecting different results." We do not want insanity to creep into our implementation of entrepreneurial supply chains.

Phase 5: Monitor and Evaluate. Monitoring progress and evaluating performance are keys to keeping the entrepreneurial supply chain implementation process

on track. This drives the feedback loop to revise and update the previous actions.

Finally: Revise as Needed. We need to revise as needed based on actual performance against the plans that were set early in the process. This could entail making revisions to the original strategic vision and/or revising the original objectives. These actions, in turn, would require some modification to the approach to and implementation of entrepreneurial supply chains.



Capturing the Value

With an understanding of how to build an entrepreneurial supply chain, we can focus on capturing the value of this endeavor. One useful way to think about this is in terms of the levels of value that can be achieved. Exhibit 3 illustrates this concept, showing the value that could be captured with entrepreneurial capability. Three capability levels are depicted:

• *Level I—As Is:* This is what a business is able to achieve with its *current* entrepreneurial supply chain capabilities, assuming that it has taken at least some of the steps outlined in this article. Most companies have at least a modicum of capability at this level.

• *Level II—Winning:* The second level shows incremental improvements that a business could achieve from *enhanced* entrepreneurial supply chain capability. Essentially this is the level that could be achieved by fully implementing the ideas, concepts, tools, and techniques outlined in this article. Attaining this level also typically requires education and training of personnel about the essence of supply chain entrepreneurship. Reaching Level II also may require hiring additional people from outside who have specific skills and capabilities in entrepreneurship.

• *Level III—Theoretical Maximum:* The highest level represents what a business could achieve in *theory* with advanced entrepreneurial supply chain capability. For most companies these are inspirational goals rather than something realistically attainable—at least in the short run. But the existence of Level III sends a message that further advancement is always possible.

One objective of this article is to help bring companies to the second level of an entrepreneurial supply chain. This is the "delta" over and above the "As Is" capability—specifically, the objectives set in Phase 2 of Exhibit 2—that will lead to superior performance and market advantage. That's why we term this level "Winning."

An Entrepreneurial Maturity Model

A well-known quote from Oliver Wendell Holmes is: "The great thing in this world is not so much where we stand, as in what direction we are moving." This quote underscores the benefit of an Entrepreneurial Supply Chain Maturity Model; it shows our current position and the direction in which we should be moving. (See Exhibit 4.)

We can overlay the three levels of Exhibit 3 with the maturity model of Exhibit 4 as a useful way of thinking about progressing toward entrepreneurial supply chains. For example, suppose we conclude that "Level I: As-Is" (in Exhibit 3) corresponds with the first level of the maturity model, "Begin to Think Long Term" (Exhibit 4). Then perhaps the middle two levels of the maturity model might correspond with "Level II: Winning" of Exhibit 3.

The author developed this practical maturity model tool for use in consulting engagements. Its elements have been taken from consulting and teaching with numerous companies, research into a wide variety of sources, and the writings of others. The tool is descriptive rather than prescriptive. It allows a company to score itself across four stages of progress—beginning to think long term, beginning to deliver value, expanding and building capability, and scaling up to long-term value—all in the context of entrepreneurial supply chain maturity. Notice that the four stages are arrayed against "business performance," with performance increasing as maturity increases.

The first phase, beginning to think long term about entrepreneurial supply chains, involves a "tooling up" of capabilities—from understanding current capabilities, identifying near-term actions, and building a business case for supply chain entrepreneurship.

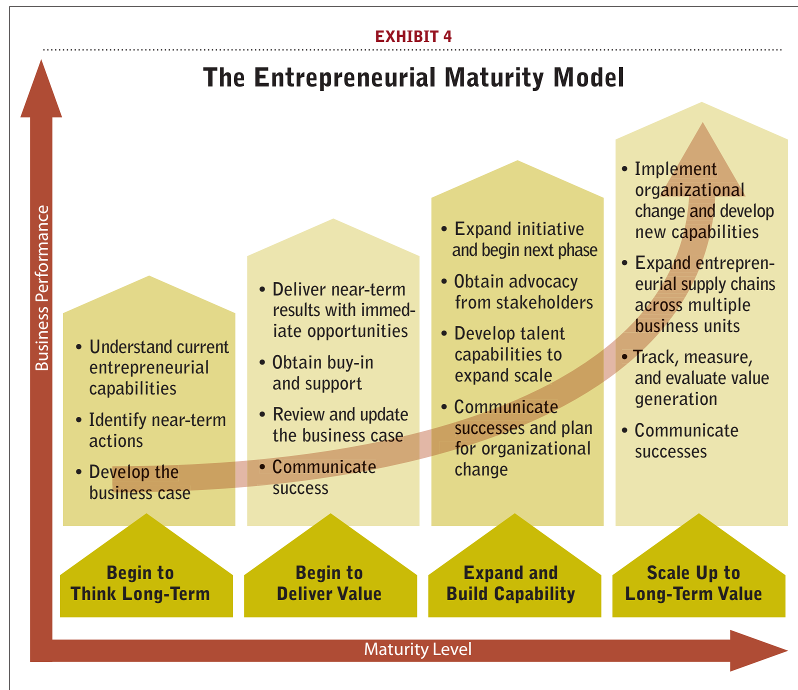
The second phase, beginning to deliver value with

entrepreneurial supply chains, focuses on near-term actions with immediate opportunities, obtaining buy-in and support from key constituencies, updating the business case with learnings from the initial actions and results, and communicating success in a way that builds awareness of results.

The next phase, expanding and building capability for entrepreneurial supply chains, effectively begins the "scaling up" process that is based on early successes. At this stage, the number and perhaps the size of the initiatives are expanded, the stakeholders visibly support and articulate the importance of entrepreneurial supply chains, the required entrepreneurial talent is beginning to be developed, and the inevitable organizational changes needed to become a real entrepreneurial organization are initiated. Building the required supply chain talent is particularly important to achieving the transition from supply chains that are based on cost, quality, and delivery to supply chains that also are innovative and entrepreneurial.

EXHIBIT 4

The Entrepreneurial Maturity Model



The final phase of our maturity model involves scaling up to create long-term value with entrepreneurial supply chains. This is the real payoff of entrepreneurship as reflected conceptually in the sweeping upward arc along the business performance axis.

Increasing the company's maturity level will likely require significant organizational change with regard to developing the talent required, expanding entrepreneurial supply chains across multiple business units, and measuring, tracking, and communicating successes with the process.

The maturity model is essentially a change enabler—a way to initiate, accelerate, and sustain transformational success. It enables the company to evaluate the as-is situation, to facilitate the process of gaining cultural acceptance of the to-be situation, and to plan a *path forward* for the transformation to entrepreneurial supply chains. The ultimate goal: improved business results.

A Context for Innovative and Entrepreneurial Supply Chains

Let's now take a close look at the notion of context in terms of what we've just discussed. A "context" for entrepreneurship is a formal process about how the organization manages its entrepreneurial supply chain ventures. Both Sysco and McDonald's are illustrative.

Sysco, the large supplier to the food-service industry, is an innovative and entrepreneurial supply chain company. As part of Sysco's overall supply chain strategy, the company had adopted a distribution "foldout" strategy—sometimes also called a breakout strategy—that reflects supply chain entrepreneurship. (This is described in a case study written by Edward D. Hess of the University of Virginia.[4]) Here's how it has worked: If a suitable acquisition candidate is not available in a certain geographic area that Sysco has been serving from other locations some distance away, they could employ the foldout approach. Once a sales level of about $100-$125 million has been achieved in that area, Sysco believes that the market would support a stand-alone operating company. The business in that area would be split off from existing operating entities, and a new foldout Sysco operating company would be established.

A hypothetical example, say, could be Bakersfield, Calif., which might be served from Los Angeles, San Francisco, and Las Vegas. Upon reaching a critical mass of business in the Bakersfield area, it could be split off as a separate foldout operating company. This would allow Los Angeles, San Francisco, and Las Vegas to pull back into smaller, more intensively served areas.

The advantages of this approach for Sysco have been numerous. In particular, putting operating companies physically closer to their customers means more attentive customer service and lower overall transportation costs. Any company such as Sysco that has geographically dispersed operations could be a candidate for such

a breakout strategy—a great example of supply chain entrepreneurship.

This approach can serve as one context for innovation and entrepreneurial supply chains; McDonald's provides another example. The fast-food company's entrepreneurial context is reflected in a success formula that has been duplicated thousands of times (replicative entrepreneurship). They have standardized everything in their stores along with their management concepts and practices so that everything can be replicated wherever or whenever a new McDonald's goes up—regardless of who the actual store owner may be. The result is a supply chain that reaches out to the customer in a systematic way and can be entrepreneurial as a result. This bakes entrepreneurial supply chains into McDonald's core ways of doing business. It is their context for entrepreneurial supply chains. One result: It's the same Big Mac whether one is in Jackson, Jeddah, or Johannesburg. It's entrepreneurial in the sense that McDonald's can replicate the success formula and the customers always know what they're getting.

There is a competitive advantage in having a context for facilitating entrepreneurial supply chains. Teams within an established company conceive, develop, launch, lead, and improve a new entrepreneurial business and need to have a context to guide them in doing so. These new ventures usually are distinct from the parent company and yet they leverage the parent company's resources, capabilities, capital, and perhaps its management, customers, suppliers, technologies, and so forth.

The importance of having a context for entrepreneurial supply chains cannot be overemphasized—it doesn't just happen, it needs to be managed. Sysco's foldout strategy is just such an entrepreneurial context—it can be replicated time and time again. McDonald's standardization strategy is another example of a company's entrepreneurial context that has been replicated thousands of times. Both of these contexts provide a framework within which successive groups of people can operate—guiding them in a way that helps ensure continuing success. As we said a little earlier, a "context" for entrepreneurship is a formal process about how the organization manages its entrepreneurial supply chain ventures.

Entrepreneurial Supply Chain Giants in History

As we finish this treatise on entrepreneurial supply chains, we turn to a little history. Our point here is that entrepreneurial supply chains have been around for a long time, but until recently have not been recognized and studied as such. We believe that the time has come for businesses, universities, and entrepreneurs to explain and advocate for entrepreneurial supply chains as a means of driving more transformation, innovation, and entrepreneurship into business ventures.

We said in the beginning that the concept of entrepreneurial supply chains is new. But now, we end by suggesting that they have been around for many, many years—albeit in different forms and under different terminology. What gives? It's just that we have not thought of the concept and have not consciously practiced it. But the message here is that we need to.

There have been many giants of entrepreneurial supply chains in history, such as John D. Rockefeller (oil),

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Henry Heinz (food), Henry Ford (automobiles), Sam Walton (retail), Steve Jobs (technology), Michael Dell (computers), and others. For this author, Commodore Cornelius Vanderbilt was one of the more interesting of these. (There's a great book on Vanderbilt by T.J. Stiles titled *The First Tycoon: The Epic Life of Cornelius Vanderbilt*.[5]) Vanderbilt certainly "reaped the payoff" by making his fortune through innovation and entrepreneurial supply chains in the mid-1800s when that terminology had not been invented. It is clear that Vanderbilt was always thinking innovatively and entrepreneurially, and linking the two concepts.

The entrepreneurial supply chain maturity model is essentially a change enabler—a way to initiate, accelerate, and sustain transformational success.

In his book, Stiles portrays the development of modern integrated supply chains without calling them that. When Vanderbilt began his career, ferries and other boats were used for transportation around New York, New England, New Jersey, and Philadelphia as well as along Long Island Sound and the Hudson River. Vanderbilt built his businesses so that he dominated water-borne transportation—initially using sailing vessels and, later, steamships. Vanderbilt innovated with the design of new steamships and other technologies of the day. His waterborne vessels soon began connecting with the new railroads that were cropping up. So not surprisingly, Vanderbilt turned his innovative powers to the running of railroad businesses, particularly as they integrated with water-borne shipping.

Vanderbilt believed in vertical integration, although he apparently did not use those words. *Vertical integration* is where a single owner takes control of businesses at every step of the supply chain. A vertically integrated company could capture profits (or reduce costs) at every point. Perhaps more important, in an age when few industries existed, it helped to ensure supply that otherwise might be diverted to a competitor. Vanderbilt's water and railroad enterprises were vertically integrated and innovative entrepreneurial supply chains in every sense of the words. This shows, once again, that history proves an insightful teacher.

Going for the Growth

We finish our discussion of entrepreneurial supply chains with three famous and very relevant quotes.

"[Plans] must lead to action; desultory talk without operational content produces paralysis."

—Dr. Henry A. Kissinger

Dr. Kissinger's quote is appropriate for reaping the payoff from the entrepreneurial supply chain venture. The key questions are *what* will be done, *who* will do it, *when* will it be done, and *what* will be the results? As he says, "Plans must lead to action." That's what the business venture is all about.

"Most innovations, especially the successful ones, result from a conscious, purposeful search for innovation opportunities, which are found only in a few situations."

—Peter F. Drucker

We mentioned earlier that two of the pillars on which this article is based are entrepreneurship and innovation. But entrepreneurship and innovation do not just happen. They are the results of "conscious, purposeful search" as Professor Drucker said. We have tried to outline some of the ways that such conscious and purposeful searching can occur and what is the expected result.

Interviewer: *"Tell me, Mr. Sutton, why do you rob banks?"*

Willie Sutton: *"Because, that's where the money is."*

—Anonymous

This famous quote illustrates why we have entrepreneurial and innovative supply chains—because that's where the money is. Or said a little differently, that's where the growth is.

Endnotes:

1 Lee, William B. and Michael R. Katzorke, *Leading Effective Supply Chain Transformations: A Guide to Sustainable World-Class Capability and Results*, Ft. Lauderdale, J. Ross Publishing, 2010.

2 Johnson, Steven, *Where Good Ideas Come From: The Natural History of Innovation*, New York, Riverhead Books, a member of Penguin Group (USA), 2010.

3 Mali, Paul, *Managing by Objectives: An Operating Guide to Faster and More Profitable Results,* New York, Wiley-Interscience, a Division of John Wiley & Sons, Inc., 1972.

4 Hess, Edward D., "Sysco Corporation," Charlottesville, Darden Business Publishing, University of Virginia, Case # UV0874, 2007.

5 Stiles, T. J., *The First Tycoon: The Epic Life of Cornelius Vanderbilt,* New York: Vintage Books/Random House, Inc., 2009.

The benefits of effective Sales & Operations Planning are compelling—lower operating costs, reduced inventory requirements, and top-line growth. The top-performing S&OP companies are realizing these benefits and in the process gaining competitive advantage. This article details the traits of the top performers and gives a practical approach to help others enhance their own S&OP performance level.

By Len Prokopets

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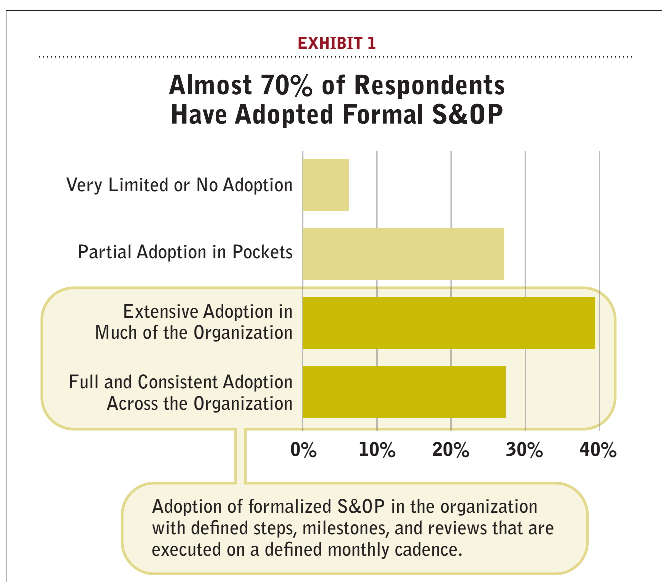
Long advocated in the pages of *Supply Chain Management Review* and by expert observers of the supply chain scene, the Sales and Operations Planning process (S&OP) has reached a point of broad adoption. A recent study performed by The Hackett Group indicates that almost 70 percent of study participants have implemented an S&OP process.[1] However, the study also reveals a wide gulf between S&OP top performers and those that merely practice S&OP. Not only do top performers apply S&OP best practices to a far greater extent, they also have begun to take the next step of integrating their S&OP and financial planning processes to drive true integrated business planning. As a result, top performing organizations find that S&OP is 68 percent more effective at driving benefits than it is for other organizations.

This article outlines study findings, provides key insights on challenges and opportunities, and offers a path forward for those seeking to join the ranks of S&OP top performers.

Let's begin with a definition. We define Sales & Operations Planning as a collaborative decision-making process used to develop and align time-phased demand, supply, and financial plans in support of the overall business plan. S&OP is, by its nature, a cross-functional process that involves individuals from sales and marketing, supply chain, finance, procurement, logistics, and even R&D and capital projects.

S&OP Has Entered the Mainstream

First emerging well over 30 years ago, S&OP has moved from business buzzword status to mainstream adoption among the world's large supply chain-focused organizations. A current Google search turns up over 860,000 entries and a search on professional networking site, LinkedIn, finds more than 16,000 individuals who list the term "S&OP" in their profiles. Reflecting S&OP's new mainstream status, The Hackett Group's recent study finds that almost 70 percent of respondents have adopted an S&OP process with defined steps, milestones, and reviews that are executed on a defined monthly cadence (see Exhibit 1). Only a small fraction of study respondents claimed "very limited or no adoption of S&OP."



Overall, these study findings are highly consistent with what we see on a day-to-day basis among our client base; the vast majority of our large clients with physical supply chains have implemented a formal S&OP process. And even among companies that have not deployed S&OP enterprise-wide, many apply S&OP to some degree in their business.

S&OP: What You Can Learn from the Top Performers

Benefits of a Mature S&OP Process

The appeal of S&OP lies in its ability to drive dramatic improvements in key business performance metrics. Our experience indicates that effective use of S&OP can help grow the top line of the business while reducing operating costs and reducing inventory required (see Exhibit 2). Few business improvement initiatives match the economic return that implementing an effective S&OP process can generate.

Our study identified a group of S&OP top performers based on their ability to maximize benefits of S&OP and operate the process more effectively. Our findings show that these top performers have realized that to truly maximize benefits of S&OP they must go beyond simply implementing a basic S&OP process and conducting meetings on an ongoing basis. These companies develop highly mature S&OP processes that leverage key best practices and as a result, realize significant performance

improvements and create an opportunity for competitive advantage. Our study findings indicate that top performer companies' mature S&OP processes are 68 percent more effective at delivering benefits than are those of other organizations.

Our study has identified a dozen key best practices that differentiate S&OP processes of top performers from those of other organizations. (See sidebar on page 35 titled "12 Best Practices of S&OP.") These best practices fall into three groups: Process, Organization, and Tools/Data. While adoption rates of the practices across these groups differ, the study indicates that top performers consistently adopt best practices at a higher rate than do other organizations.

On the whole, top performers adopted these S&OP best practices at a rate that is 52 percent higher than that of other organizations, developing more mature S&OP processes and delivering superior benefits.

When it comes to S&OP process best practices (see Exhibit 3), almost all top performers report having an S&OP process that is formalized in the organization with defined steps, milestones, and reviews that are executed on a defined monthly cadence. Top performers also report developing a single consensus demand plan that is used as an input to S&OP. In addition, these organizations develop a robust supply plan that defines the manufacturing and supply operating activities required to meet demand and highlights supply constraints as well as situations where key parameters cannot be met (e.g., capacity utilization, inventory levels, operating cost levels).

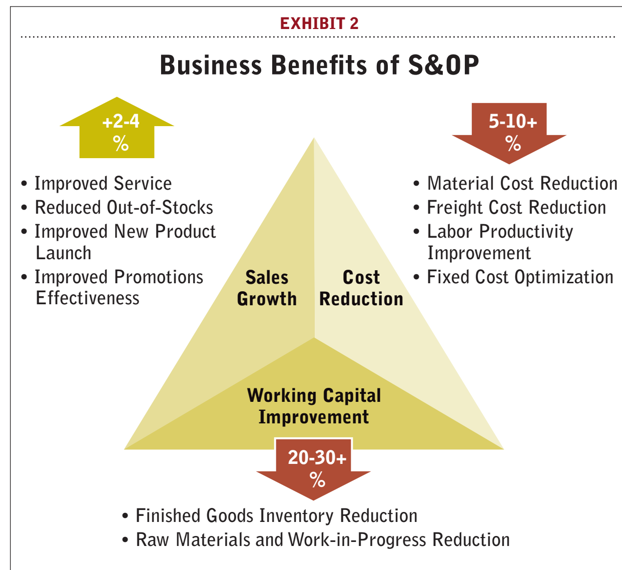
Top performers also gear their S&OP processes to look out over a horizon of at least 18 months, producing an integrated business plan that balances supply and demand to meet targeted business objectives over that timeframe. Organizations that are not top performers lag in each one of these best practice capability areas.

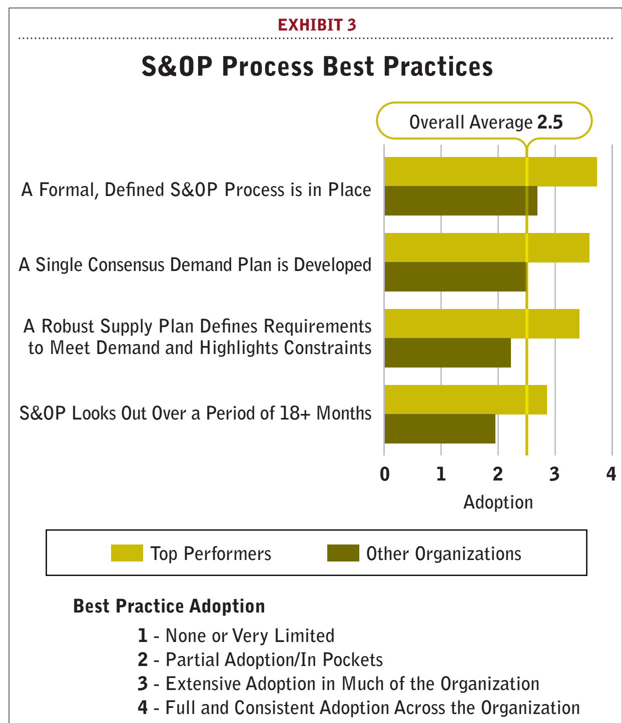
Another trait of the top performers is to aggressively adopt organizational best practices (see Exhibit 4), surpassing adoption rates by other survey respondents by 44 percent. In our experience, organizational effectiveness is a key ingredient to S&OP success, enabling ongoing governance and continuous improvement of the process.

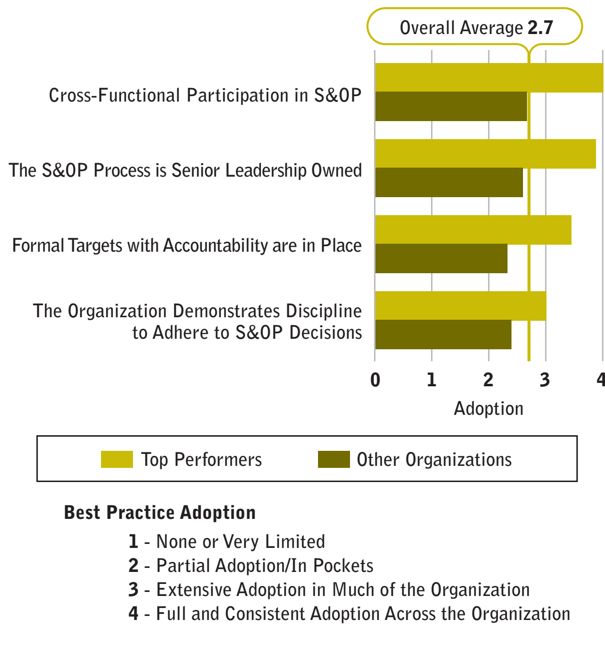
Almost all top performer organizations report participation by sales, marketing, demand planning, supply planning, finance and procurement functions in their S&OP process. They also report that their S&OP processes are owned by senior leadership. Effective ownership by senior leadership typically includes the following elements:

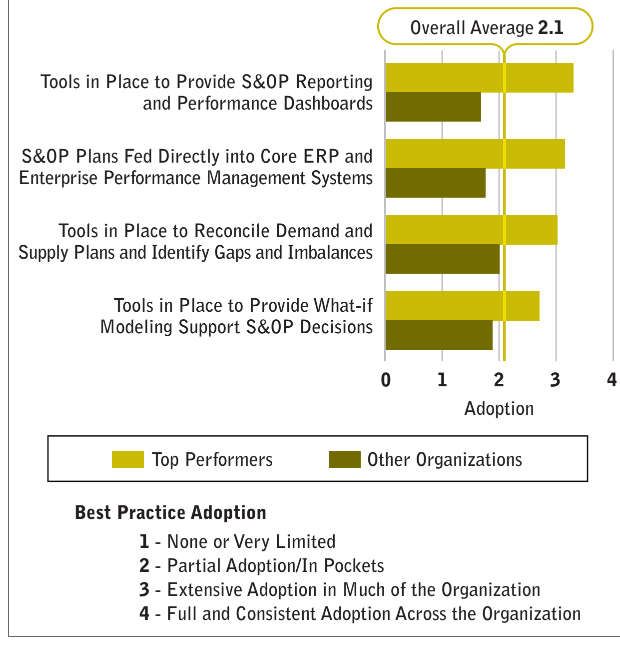
- Setting and communicating goals and expectations for the overall process.
- Measuring the entire team as well as themselves against the goals each period.
- Participating in the process in a visible, active way.
- Using all available information to make data-driven decisions to resolve issues.
- Owning and adhering to the plans developed through the S&OP process.

Top performers also set formal performance targets and assign accountability for achieving those targets. The targets are typically specific quantifiable goals









with defined timeframes in areas such as working capital improvement, cost reduction, customer or product growth, forecast accuracy improvement, supply gap reduction, and process participation.

Top performers also have developed the organizational discipline to stick to and carry out decisions reached as part of their S&OP processes. In organizations that lack such discipline, inevitable day-to-day firefighting and changes in business priorities provide excuses for lack of follow-through and failure to execute on decisions and actions defined in S&OP. As a result, S&OP effectiveness can be severely limited.

Top performers also are significantly ahead of other organizations in system enablement of S&OP (see Exhibit 5), reporting adoption levels that are 66 percent higher. Most top performers have system/tool capabilities in place to produce trend reports, exception reports, and performance dashboards to support Integrated Business Plan review and ongoing improvement. They have the tools and systems needed to bring together and reconcile demand plans and supply plans at a granular enough level to identify gaps and imbalances between those plans. They also have put in place tools and systems to conduct what-if modeling in order to evaluate and resolve those supply/demand gaps and imbalances. Once they produce an Integrated Business Plan at the conclusion of the S&OP process, they are able to feed the plan directly into their Enterprise Resource Planning (ERP) and Enterprise Performance Management (EPM) systems.

While top performers are substantially ahead of other organizations in this area, systems tools and data capabilities remain the weak link of their S&OP capabilities. In our experience, even top performers struggle to build robust S&OP tools and data. One key reason is that ERP packages and other enterprise tools do not come configured to effectively support S&OP "off the shelf." To overcome this system support gap, top performers work over time to develop operational and performance reporting, data interfaces, tools to reconcile and align demand and supply, as well as tools that enable modeling of what-if scenarios.

The lack of off-the-shelf ERP support for typical S&OP requirements also means that the systems and tools developed—even those of top performer organizations—are often homegrown using Microsoft Excel and Access.

A number of packaged solutions have recently emerged that provide key functionality to enable and automate S&OP activities such as planning, reporting, and analysis. As these solutions are more widely adopted and as ERP packages add S&OP related functionality in the coming years, we anticipate further adoption of best practice capabilities of the tools and data associated with S&OP.

Integration with Financial Planning

A traditional, limited, definition of S&OP focuses on balancing the organization's supply and demand and resolv-

The appeal of S&OP lies in its ability to drive dramatic improvements in key business performance metrics.

ing supply disruptions and shortages. In our experience, organizations with immature S&OP view the process in this limited way. In fact, our study indicates that outside the ranks of top performers, 75 percent of organizations execute this traditional "blocking and tackling" version of S&OP.

Top performers, however, have realized that S&OP can play a role that is much more valuable than that of balancing supply and demand. They believe that S&OP can serve as a process for business management and optimization. These companies have integrated their S&OP and financial planning processes, enabling true Integrated Business Planning. In effect, they have identified a thirteenth best practice that builds upon the first 12.

Our study indicates that almost 88 percent of S&OP top performers have integrated S&OP and financial planning as compared to only 25 percent of non top-performers. The 250 percent difference in rate of adoption of Integrated Business Planning is truly striking. In our experience, organizations that have adopted this capability have been able to realize the greatest value from S&OP.

Adopting Integrated Business Planning enables top performers to link business execution activities (sales and marketing, manufacturing, and procurement as well as other functions) across functions and to better align them with the organization's business plan. Exhibit 6 depicts the components of the end-to-end Integrated Business Planning process. With the degree of integration that this process provides, senior leadership has the ability to understand impact of decisions on the business as a whole and can take steps to "optimize" business performance.

Enabling Integrated Business Planning relies on a number of key building blocks. Top performer organizations typically bring together the following elements to support an Integrated Business Planning environment:

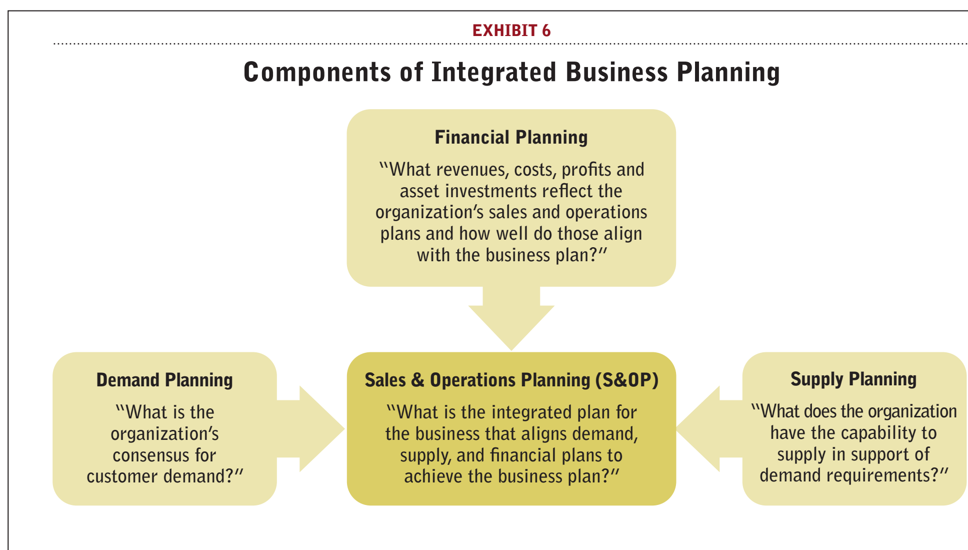
- An integrated process for generating and aligning the plans of the individual functions.
- A common/aligned planning calendar defining milestone dates.
- A common planning time horizon (for example, 18 months).
- Planning assumptions that are aligned across the organization.
- Standardized and aligned metrics and targets across the organization.
- An integrated cross-functional data model enabling rapid integration of cross-functional plans.
- A culture that enables effective cross-functional collaboration.
- Cross-functional modeling of business scenarios to understand full business impacts.
- Development of a single integrated plan that can be fed back to individual processes/subsystems.

For top performer organizations, this shift toward integrated S&OP and financial planning processes has coincided with a dramatic change in the role that finance plays in the organization. Finance's traditional role has been to "record the numbers", keep score of performance relative to the budget, serve as the source for financial data (costs, pricing, and so forth), and conduct analysis to answer the organizations questions about performance.

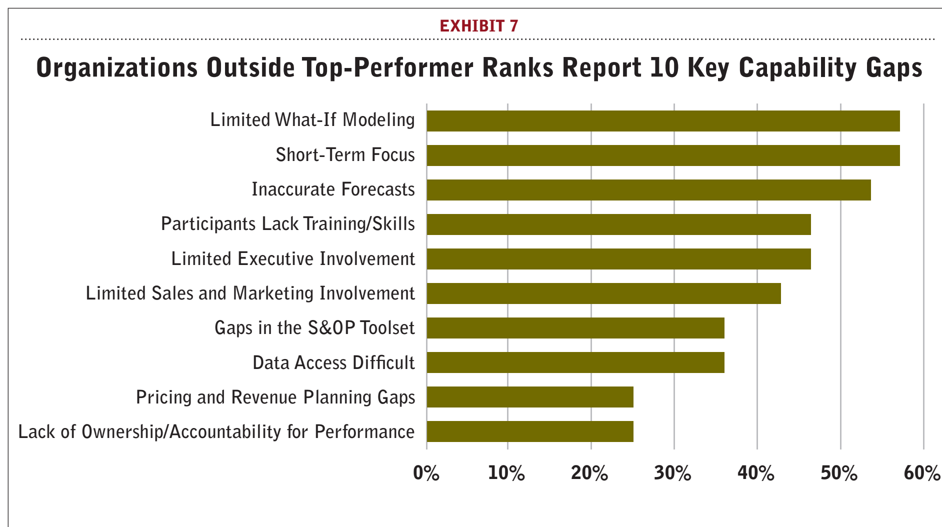
The finance role that is emerging is to "Lead the organization in making the numbers." This new role entails the following: coordinating the overall Integrated Business Planning process; defining priorities and targets for key busi-

EXHIBIT 6

Components of Integrated Business Planning



ness metrics; driving business decision-making; and supporting a broader range of what-if analysis to support cross-functional business decisions.



Capability Gaps of the Lesser Performers

Turning now to the lagging companies, our experience indicates that organizations that are not S&OP top performers struggle with a number of gaps, hampering full adoption of the S&OP process and limiting benefit realization. The study confirms this experience; non-top-performer organizations reported facing ten major S&OP capability gaps, as shown in Exhibit 7. Among those, a majority of respondents reported five or more gaps in their S&OP capabilities. The gaps cited most frequently are limited what-if modeling, a short-term focus, and inaccurate demand forecasts.

Case Study of an S&OP Top Performer

The following case study highlights many of the best practices associated with putting a successful S&OP into action. The company, a $1billion-plus manufacturer, faced a set of business and operational challenges. The external business environment was unfavorable, with weak customer demand and rising costs. At the same time, the organization experienced many of the typical capability gaps resulting from an immature S&OP process. The supply chain was unstable, providing poor customer service levels while operating inefficiently. In particular:

• Customer service levels were sub-par, with order fill rates averaging below 96 percent in an industry where customers expect 98.5 percent.

• Protracted product outages resulted in major disruptions for key customers, endangering major account relationships.

• Significant manufacturing variances arose, driven by frequent changes in the production schedule, at times made to satisfy unexpected demand and at others made in reaction to materials or packaging shortages.

• Sales and marketing lacked the confidence to plan promotions and new sales due to concerns that supply chain would be unable to respond.

Furthermore, financial performance surprises were routine, frustrating senior leadership and precipitating a monthly game of "whack-a-mole" that included chasing and firefighting the latest set of issues.

Facing pressure to improve business performance, the organization's senior leadership team initiated a project to put in place world-class Integrated Business Planning/S&OP capabilities. The effort consisted of three phases:

Phase 1: Preparation

• The organization took action to rapidly stabilize its supply chain environment, identifying and addressing underlying gaps and disconnects in demand, supply, and financial processes and tackling major issues and risks for specific products to stabilize the business.

• The organization designed and implemented S&OP capability improvements in each of the 12 best practice areas in process, organization, and tools/data. Examples include:

–Established a formal monthly S&OP process including repeatable tools, templates, and approaches for gap modeling and resolution.

–Shifted focus of the S&OP process from planning the current quarter to planning a rolling 18-month period.

–Established visible C-level ownership of the process and hands-on involvement in monthly meetings.

–Developed an integrated data model as a "single source of truth" for supply, demand, cost, and pricing data enabling the linking plans and metrics across business functions.

–Developed operating and performance reports to support S&OP.

–Built analytical tools to support what-if analysis and

scenario modeling.

• The organization integrated its S&OP and financial planning processes, creating a single monthly process for Integrated Business Planning:

–S&OP plans and what-if analyses were translated into dollar terms focusing decision-making on business performance impacts.

–A P&L, generated for each month in the planning horizon as part of the S&OP process, became the financial plan, eliminating the need for a separate financial planning process.

–Established a framework for continuous improvement of S&OP with a balanced set of quarterly targets for business performance and for improvement in process execution.

Phase 2: Conduct Pilot Cycles

• After a rapid effort to implement improvements in S&OP process, organization, and tools/data elements, the organization conducted three pilot cycles of the improved S&OP process.

• The pilot cycles were used as an opportunity to train process participants and prepare them to operate in an Integrated Business Planning environment.

• The S&OP design was refined with each successive cycle leading to a full launch after an executive leadership go/no-go review.

Phase 3: Implement Continuous Improvement

• The organization monitored S&OP performance and process execution measures and defined necessary changes and actions to drive improvement.

• Tools and templates were refined over time. The company transitioned tools that had been built in Microsoft Excel and Access to leverage more powerful enterprise toolsets such as the ERP system, financial planning system, and supply chain system.

The project yielded exceptional results, providing senior leadership with the tools to better manage the business and driving substantial operational and economic improvements. Customer service fill rates rose from 4th quartile to 1st quartile in four months, consistently achieving targeted 98.5 percent fill rates. Simultaneously, finished goods inventory was reduced by 10 percent. Expediting was substantially reduced enabling reduction in raw material and packaging costs. Finally, the improved stability of the supply chain enabled management to redesign and rationalize the manufacturing network, reducing overhead costs by 10 percent.

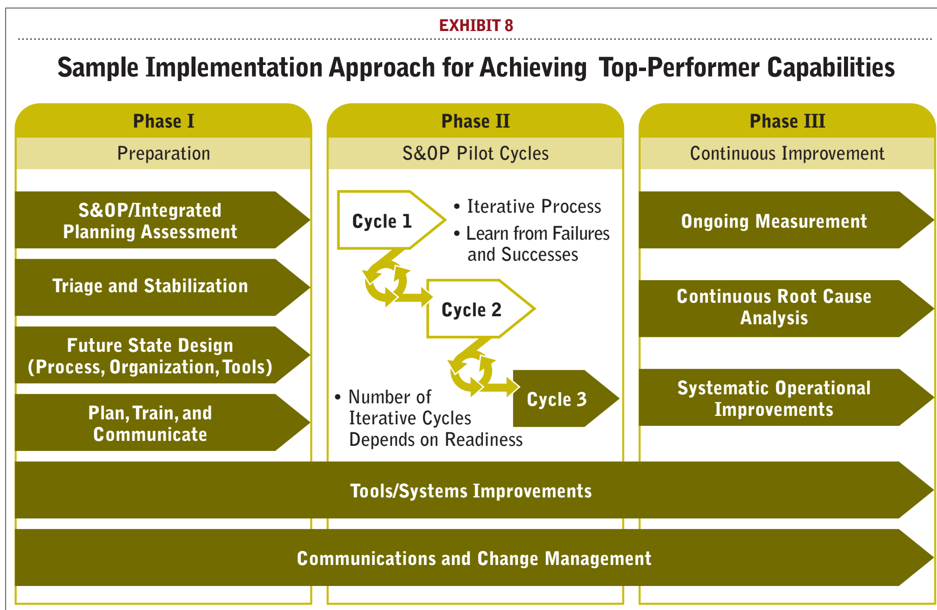
How to Become an S&OP Top Performer

Achieving S&OP top performer capabilities and performance requires a focused effort, dedicated, knowledgeable resources, and at least six months. Such a project is typically comprised of three phases: Preparation, S&OP Pilot Cycles, and Continuous Improvement. Exhibit 8 provides a sample implementation approach.

In many organizations, an initial S&OP assessment reveals gaps, breakdowns, and individual supply, demand, and financial and business plans that are ineffective and can complicate or prevent implementation of overall S&OP capabilities. In these organizations, an additional triage and stabilization step may be necessary to address gaps and disconnects and establish a starting point for developing an Integrated Business Planning process.

Once the current S&OP environment has been stabilized, the typical next step is to develop the future state design. This design should, among other changes, put in place the 12 key best practices across S&OP process, S&OP organization, and S&OP tools/data (see sidebar).

Once a critical mass of process, organization, and tools/data capabilities are in place, the next step is often to execute



12 Best Practices of S&OP

Processes

1. A formal, defined S&OP process.
2. A single consensus demand plan.
3. S&OP that looks out over a period of 18-plus months.
4. A supply plan that defines requirements to meet demand and highlights constraints.

Organization

5. Cross-functional participation in S&OP.
6. S&OP process is senior-leadership owned.
7. Formal targets with accountability are in place.
8. Discipline in the organization to adhere to S&OP decisions.

Tools/Data

9. S&OP reporting and performance dashboards.
10. S&OP plans fed directly into core WERP and EPM systems.
11. Ability to reconcile demand and supply plans and identify gaps and imbalances.
12. Ability to conduct what-if modeling supporting S&OP decisions.

a series of monthly pilot cycles, putting into action the new S&OP design. Pilot cycles allow for trial and error and course corrections. They also help build the organization's comfort level and "muscle memory" to enable sustained execution of the process. Once the pilot cycles are completed, organizations typically transition to a mode of continuous improvement that focuses on measuring performance, addressing issues and gaps, and executing further improvements in S&OP capabilities on an ongoing basis.

As top performers have experienced, a mature, best-practice-based S&OP process is a very powerful mechanism for managing the business and maximizing performance. Through a strong governance process and continuous progress, these improvements can be sustained over time, leading to a significant competitive advantage for the organization.

Endnotes:

1 The Hackett Group's 2011 Study of Sales and Operations Planning Practices, Benefits, and Trends included 35 Global manufacturers.

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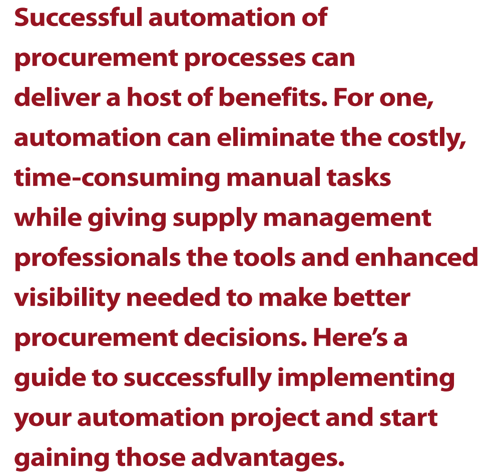
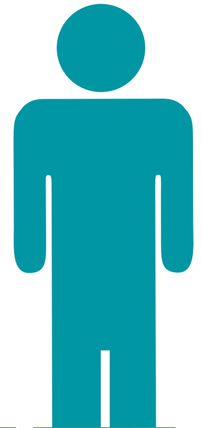


Successful automation of procurement processes can deliver a host of benefits. For one, automation can eliminate the costly, time-consuming manual tasks while giving supply management professionals the tools and enhanced visibility needed to make better procurement decisions. Here's a guide to successfully implementing your automation project and start gaining those advantages.

By Andrew Bartolini

Andrew Bartolini (abartolini@ardentpartners.com) is the Chief Research Officer at Ardent Partners, a research and advisory firm focused on defining, advancing, and promoting the supply management strategies, processes, and technologies that drive business value and accelerate organizational transformation. Ardent also advises companies on the selection, deployment, and usage of supply management solutions.

Procurement Automation: How to Do it RIGHT



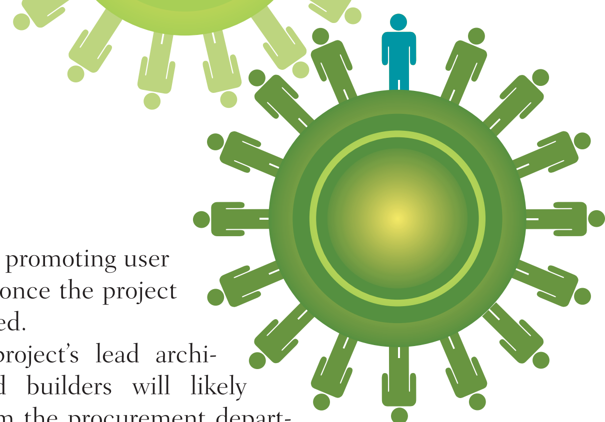
Over the past 15 years, many procurement departments have participated in a broad transformation of their function and gained greater awareness and relevance within the executive quarters. A large number of those procurement departments leveraged supply management technology to enable their transformation. Supply management solutions automate the sourcing, procurement, and accounts payable functions commonly referred to as the Source-to-Settle process. The primary applications that fall under this category are (1) *spend analysis,* which helps companies aggregate, classify, cleanse, and analyze their supplier spend information; (2) *eSourcing*, which automates the sourcing or bid process; (3) *contract management*, which automates the supplier contracting process; (4) *eProcurement*, which automates the requisition to purchase order process; and (5) *ePayables*, which automates the accounts payable process.

These solutions can drive efficiencies and savings and help organizations become more effective. (We've included two case study sidebars in this article that serve as examples.) In fact, when deployed successfully, these solutions can deliver some of the most compelling and competitive returns on an investment in enterprise technology available in the market. That means that these projects are absolutely worth undertaking.

Unfortunately, as with any IT project, the returns on these investments are far from guaranteed. There are many potential pitfalls and landmines that can pull a supply management automation project off of its course. The good news is that over the past 15 years, many, many groups have been successful. And these successes have helped establish standard industry best practices. In this article we highlight those best practices that can lead to a successful purchasing automation project. Our discussion follows this sequence: laying the groundwork for a successful automation project; managing the RFP process; and deploying the solution selected.

Laying the Groundwork

There are numerous steps involved in selecting a solution to automate supply management processes. These steps are critical to the overall success of your initiative as they help set the foundation for a successful program.



The following are some best practices uncovered by our years of research and direct experience in selecting and deploying supply management solutions as well as numerous discussions with best-in-class practitioners. These strategies can help your procurement department establish a solid foundation upon which to launch a successful automation initiative.

Gain Support of Stakeholders

As with any IT initiative, one of the first actions is to gain executive or senior-level support for the project as well as support from all other relevant stakeholders. A larger set of project stakeholders will bring a wider set of interests, priorities, and requirements to the discussion. The earlier these different inputs are identified and understood by the larger team, the sooner they can be rationalized and prioritized into a comprehensive plan. The wider involvement of stakeholders is also a proven technique for establishing project buy-in at an early stage and promoting user adoption once the project is launched.

The project's lead architects and builders will likely come from the procurement department. However, wider collaboration is needed, so input should be gathered and incorporated from other stakeholders, including:

- **Line of Business:** End-user adoption rates will have an enormous impact on the program's overall success. If a large number of system users will come from the business, then the relevant lines of business should have a representative voice in the solution selection and design processes.
- **IT:** Since this function typically understands the enterprise's current IT infrastructure, it can help to define any integration requirements and/or constraints. IT may also possess the general technical expertise needed to help identify the supply management solutions with the lowest total cost of ownership
- **Finance.** Finance can help validate the business case for investment in technology. It also may offer strong support in discussing how a supply management solution can help drive efficiencies, visibility, and effectiveness.
- **Supply Chain & Logistics.** Engagement of logistics and supply chain is key as these functions support the processes that are complementary to the sourcing/procurement processes and direct interactions with suppliers.
- **Other Procurement Staff or Users.** These are the frontline users performing the processes that will be impacted by the new solution. This group may be able to support the discussions around how a supply management solution can improve group operations and performance
- **Suppliers.** Supplier enablement or adoption can be the "Achilles heel" of any supply management project. Understanding the inclination and preferences of suppliers regarding different solutions, while not critical, can help the project team better understand what's required to enable suppliers onto the new platform.

Understand Current Process

Understanding the current process for sourcing, contracting, and requisitioning is critical to making improvements. Whether the plan is to automate the entire Source-to-Settle process or just some part of it, it is important to understand the process as it currently works. Identifying the current process will allow the organization to uncover specific pain points, which

Case Study: Savings through Spend Analysis

HealthTrust Purchasing Group (HealthTrust) is one of the United States' largest health-care GPOs, with more than $18.1 billon in spend under contract including supplies, pharmaceuticals, medical devices, capital equipment, HR and other service-related offerings.

From HealthTrust's perspective, off-contract purchasing chips away at its purchasing leverage and contracting philosophy that provides a sustainable price advantage for its members. It also dilutes HealthTrust's goal of members being 100 percent aligned on clinical decisions, contracting strategy, and implementation to support its "patients first" mission.

More recently, gaining visibility into the who, when, where, and how of off-contract spending became a top priority for HealthTrust. With thousands of monthly transactions by hundreds of members, it was difficult track off-contract buying. To gain better visibility into areas of savings leakage and improve compliance tracking, the HealthTrust team selected BravoSolution's Spend Analysis solution to help actively monitor compliance with its existing agreements by analyzing pricing and purchases, thereby allowing members to quickly address missed savings opportunities.

One compelling savings example was illustrated by the experience of one of the GPOs' large members. This hospital network already had strong controls and processes in place but was able to identify $2 million in savings by leveraging automation to track overpayments made in the last eight months.

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in turn will help to refine automation requirements. Additionally, it is good practice to establish key performance metrics (like savings and compliance rates) and operational metrics (such as user adoption and business process cycle time) before automation so that improvements can be measured.

Establish a Blueprint

In order to establish a solid foundation for the project it is important to develop a long-term strategy and plan (in effect, the business case). To do this, the organization must have a clear sense of the long-term goals and objectives of the automation initiative and its potential impact on the enterprise. For example, if you consider the entire Procure-to-Pay process, the work in accounts payable (AP) is really the second half of a process that began in procurement. This makes it wise to take into consideration the systems/processes that AP already has in place or plans to deploy. For such reasons, you need a blueprint that will both help provide an understanding of the current state and ensure that the desired outcome is achieved. The blueprint should consider all of the following:

- Process efficiency and savings goals.
- System capabilities (requirements and desired).
- Integration requirements.
- Visibility and reporting capabilities.
- Business user engagement, requirements, and adoption.
- Functional user engagement, requirements, and adoption.
- Supplier enablement strategy.
- Procurement processes and technology.
- Process, contract, and regulatory compliance.
- Budget and timeline estimates.

Determine Technology Delivery Approach

Before going down the path of selecting a solution, determine what method of solution delivery (installed/on-premise or cloud-based) is appropriate for your organization. The IT department may have certain requirements that could limit certain options; therefore, it is important to involve them from the beginning. The two main delivery methods are described below:

1. Cloud-based Solution: Software delivered in the cloud (also referred to as on-demand or SaaS) is typically hosted, maintained, enhanced, managed, and upgraded on the application and server side hardware infrastructure by the cloud solution provider. Generally, the user pays for the solution on a consumption or time-period basis (rather than the traditional perpetual license).

Cloud-based solutions typically have the following characteristics:

- Accessed via the web.
- Cost based upon usage (i.e., subscription and/or transaction-based fee vs. upfront investment).
- Provider required to maintain the software (often with the use of service level agreements, or SLAs).
- Hosted or resides at a centralized facility.
- Multi-tenant architecture.
- Capable of quick utilization.
- Constraints in what can be customized in the solution; solutions often have a distinct list of configurable items or features.

One of the first actions is to gain executive support for the project as well as support from all other relevant stakeholders.

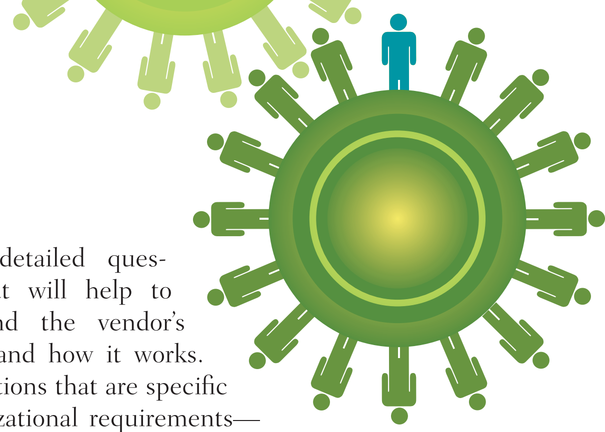
2. Installed On-Premise Solution: With this model, the software is installed and deployed on the servers at the client's site. This typically requires heavier involvement from the client's IT department and/or a third-party consultant. Also, there is usually a larger one-time upfront license fee for such a model, allowing for perpetual use of the solution. (There may also be transaction-based fees). Additionally, implementation periods are usually longer due to the need to develop the entire site/instance infrastructure, including hardware configuration, and possibly to develop a higher level of customization.

Some providers offer their installed solution via an Application Service Provider (ASP) approach, which is an outsourced or third-party hosting solution. This is differentiated from a true "cloud" solution in that the ASP can host and manage an installed solution from a central facility, allowing clients the ability to access the application over the internet instead of installing the software onsite.

Managing the RFP Process

While it takes some effort to get to the RFP stage—getting buy-in from key stakeholders, determining organizational requirements and getting the business case and budget approved—the success rate of a project is much higher if all the internal requirements have been met before actually selecting a solution.

The Request for Proposal (RFP) process can be a lengthy and complex one, but it is absolutely critical to



the project's overall success. If the RFP process is poorly executed, serious consequences can result and then linger within the enterprise for years. If the team lacks experienced resources and has available budget, leveraging the support of a third-party expert in the RFP process can pay huge rewards. Below we discuss the key elements of the RFP process.

The RFP

The goal of an RFP is to get a detailed view into the top providers' solutions and gain a better understanding of how their products/services, strengths and experience match with internal requirements. To get the best information from the providers, it is important to share information with them. Therefore, the RFP must clearly convey the goals and objectives of the project and include the specific requirements you have deemed necessary based on research and input from cross-functional stakeholders. Vendors' responses are more likely to be focused and relevant if they are well equipped with information about the project.

When Ardent Partners advises its clients on selecting automation solutions, we encourage them to incorporate the following elements in their RFP:

- **Introduction:** Start the RFP by providing an introduction to your company and the project. Include information that will provide some insight into the project's goals and objectives as well as some of the key requirements so the vendors have a good understanding of the scope. Also, be sure to include the necessary confidentiality and non-disclosure agreements.

With the compelling ROIs on supply management technologies that we continue to see, it's clear that investing in procurement automation is no longer optional.

- **Company Profile:** This section should ask for general information related to the vendor company—history, description, mission and vision, financials, customers, industries, and so forth.
- **Technology:** This section is to better understand the providers' platform and technology architecture and details around integration to your internal systems and security features.
- **Functionality/Capability:** One of the most important parts of the RFP, this section focuses on vendor's features, functionality, and capabilities. It should include detailed questions that will help to understand the vendor's solution and how it works. Ask questions that are specific to organizational requirements—for example, eInvoicing, supplier network, dynamic discounting, and global capabilities.
- **Pricing:** This section requests detailed pricing from vendors. It should include a framework in which vendors can respond that allows you to compare pricing in an "apples-to-apples" way.
- **Services and Support:** Information should be requested regarding the type of technical and expert support that is offered. This section of the RFP also should ask questions around solution training and the implementation process.
- **Client References:** Ask for three to five current and past client references and, if possible, speak with these references before making a selection. The conversation should focus on :

–Return on Investment (ROI) and payback period.
–Service and support.
–Challenges faced with solution provider.
–Availability and responsiveness of the provider.
–Costs and expenses, especially hidden costs.

Technology Demo

In addition to the technology-specific questions in the RFP, it's good practice to request a detailed live demo of the product. Depending on the number of solution providers participating in the RFP, this is typically done after a short-list has been determined. It may be beneficial if some or all of the extended team (i.e., key stakeholders) are invited to the demo, so they can begin to get a feel for the technology. It is important to prepare for the demo. Know what questions to ask and consider sending the vendor a list of items to cover during the demo.

In some situations a test run (or pilot) may also be appropriate. For example, if the team is considering a spend analysis solution, it may help to ask the shortlisted providers to classify, cleanse, and analyze a subset of the total enterprise spend and present the data for analysis by the internal project team within the proposed tools.

Deploying the Solution

Once the best-fit solution has been selected, the fun really begins. Solution deployment is a process with multiple moving parts that requires full attention. Beyond

the standard IT project management strategies, here are a few areas that can lead to a smoother deployment and higher adoption.

Align Systems and Processes

The misalignment of systems and processes can be a huge impediment to the overall adoption of supply management solutions by users. This happens when project or process teams dream big and aim to play big with dynamic, robust but overly-complex designs. Or it might be designs that look good on paper but when viewed through the looking glass out in the field are far beyond even the best capabilities of the practitioners, the doers. Here are a few ideas on how to avoid the misalignment of systems and processes:

- Get the process right before thinking about the technology. Do the process groundwork and then involve the doers in the design and vetting of the design in the field.
- Never lose sight of the process objective (what you are trying to achieve by doing the activity in the first place) and take a "results first" focus on process design.
- Understand that the initiative's success is more likely tied to effective change management than in getting the design "right." Moving legacy, off-line processes into an online application is viewed by many, if not most, practitioners as a huge and disruptive change. Underestimating the full amount of change management required defeats many process automation initiatives.

Monitor Progress and Update Stakeholders

Internal stakeholders have been an integral part of the project since the beginning and they must be kept up-to-date on the progress. Ensure that the project team and the solution/service provider work closely together throughout the deployment so that everyone stays on the same page. A poorly managed project, combined with inadequate communication, is major factor in unsuccessful projects. Therefore, it is important to monitor each milestone and provide regular updates and progress reports to the stakeholders. Having a dedicated project manager is essential in this regard.

Prevent Scope Creep

Scope creep and solution deployments go hand in hand; project teams must be vigilant. With so many moving parts, and multiple people with multiple deliverables and changing responsibilities, it is easy to lose sight of the project's initial goals. Sometimes a change in scope is inevitable. However, a project plan that provides a focused and well-defined scope and requirements—and includes the appropriate resources—will help keep the project on track.

Include Service Level Agreements and Contracts

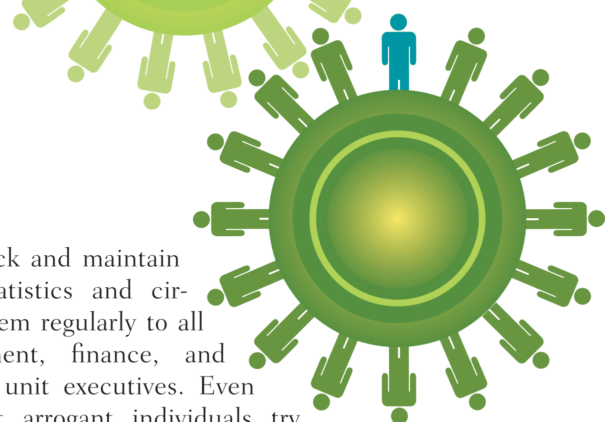
The people involved in the original negotiations during a software selection are usually not the same people assigned to deploy it. For this reason, have the solution provider include a service level agreement (SLA) or statement of work (SOW) as part of, or in addition to, the software contract. To ensure successful deployment of the solution, try to link payments to specific deployment milestones, for example, tying the timing of the license or subscription fee to the solution's successful launch. During the deployment stage, additional products or services are often required. It's a good strategy,

Case Study: Dollar Benefits of Automation

Blue Cross Blue Shield of Rhode Island (BCBSRI) set out to make significant changes to improve processes to increase spend under management. The company began its procurement transformation by centralizing the procurement function. It added external talent with strengths in strategic sourcing, analytics, and negotiations and created a performance based culture. A new purchasing policy and six-step strategic sourcing and vendor management process rooted in best practices was implemented.

The next step was the implementation of an end-to-end procure-to-pay solution to tie in all of the processes, goals, and strategies set forth. Puridiom 4.0 Enterprise Cloud solution was the selected solution. It enabled automation of the antiquated and manual P2P process, which enhanced the procurement team's ability to influence vendor spend. The solution further enabled suppliers to transact electronically with BCBSRI, increasing efficiency of the cost accounting and finance teams while allowing the procurement team to negotiate fast-pay discounts. Other capabilities allowed the company to track cost savings and ensure tie-in with budgets; create access to timely and quality spend data with rich reporting; and assist in measuring and improving vendor performance.

Through this automation initiative, BCBSRI has improved overall performance, increased budget compliance, enforced process compliance, reduced maverick spending, increased spend under management and visibility, and focused resources on high value and strategic activities. The company has projected savings from this project to exceed $1.9 million.



therefore, to nail down the costs of these additional products/services in the beginning. For example, set the hourly rates for development work or the cost to add an additional module to the solution.

Conduct Appropriate Training

It goes without saying that training is an important driver of user adoption and overall program success. While the usability of supply management solutions has greatly improved over the past five years, training is recommended for most system launches. From a scheduling standpoint, do your best to initially train users as close as possible to the time when they will first begin using the solution. Remember that many users will be logging in to use the system infrequently; so they will need ongoing access to support. Develop internal application expertise to serve as ad hoc trainers and power users to support the larger group. Finally, maintain an ongoing training program so users can reinforce what they have already learned and keep current on new system capabilities as they become available.

The development of a Best-in-Class procurement automation initiative takes (among other things) sponsorship, effort, collaboration, vision, expertise, and a supporting technology infrastructure.

Pay Attention to Change Management

Supply management technology deployment represents a big change management initiative. And, as such, it can hit a few classic roadblocks. Among the most common is one we refer to as the NIMBY (not in my backyard) effect. This is where people say that while the new process and technology sounds great, they just do not, should not, or cannot apply to them (or in their "backyard"). NIMBY is typically a blend of arrogance and fear of change within organizations. Even with a strong mandate in your organization, this can be a real issue. Here are some ideas on how to counteract the NIMBY effect:

• Argue the base case benefits of the solution: visibility, efficiency, knowledge capture and retention, best practice development, and so forth.

• Challenge the NIMBY proponents on their arrogance, parochialism or drawbridge mentality as well as their failure to support enterprise objectives.

• Track and maintain usage statistics and circulate them regularly to all procurement, finance, and business unit executives. Even the most arrogant individuals try to avoid being on high-profile "negative" lists. Reward the heavy users, engage those that are not, and provide support for everyone.

Do a Perpetual Sell

Whether or not there is a usage mandate, project leaders need to continue making the business case for usage to their stakeholders after deployment. You just don't want people to use the solution; you want them to want to use the solution. Create case studies, share usage data, share mini-project ROI data with a goal of creating an environment that draws people to the solutions and rewards them for usage. And importantly, when they don't use the solution that well, support them (don't punish them).

Toward Operational Excellence

It is clear that procurement is a function that can significantly impact the business process and can significantly impact business results. Best-in-Class procurement leaders know that having a solid technology platform to drive their processes helps maximize their results. The development of a Best-in-Class procurement automation initiative takes among other things, sponsorship, effort, collaboration, vision, expertise, and a supporting technology infrastructure. Superior program design is another critical element in the speed and level of operational excellence and performance results that are ultimately achieved.

Over the past decade, we have witnessed phenomenal advances in supply management automation technology. We have seen advances in specific features and functionality within the different applications and we have seen these solutions better able to integrate to other systems and tightly link business processes. New deployment methodologies, improved usability, and competitive pricing also have helped make the solutions accessible to most companies in the marketplace. With the compelling ROIs on supply management technologies that we continue to see generated by the companies we work with, it's clears that investing in procurement automation is no longer optional. It is, in fact, a key strategy in achieving operational excellence.

Merger and acquisition activity is set to be a prominent driver of growth for many businesses in the next few years. The upshot for supply chain chiefs in those companies: a fresh chance to produce significant shareholder value. Yet, post-merger supply chain integration has been found wanting in the past. This deconstruction of the M&A process shows how supply chain leaders can step up to the challenge.

By Foster Finley and John Bonno

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Over the next few years, companies and their financial backers will look to mergers and acquisitions (M&A) as a means of increasing shareholder value. The latest survey by AlixPartners and the Economist Intelligence Unit found that many executives see acquisitions as a key growth tool in the next year. When asked how they might use their cash for their domestic operations, 29 percent said they intend to use it to make acquisitions, with 26 percent saying the same regarding their overseas operations.[1] Most forecasts indicate that 2012 M&A activity will be comparable to recent years, showing no signs of slowing down despite cautious global economic forecasts.

This offers supply chain leaders fresh opportunities to add substantial value to their organizations. It's a welcome development.

M&As OFFER BIG OPPORTUNITY for Supply Chain Leaders

Often, the supply chain is expected to offer one of the greatest, if not *the* greatest, financial opportunities for generating benefits in a merger. Indeed, supply chain executives are pressured to start showing results almost as soon as a merger is announced. They're expected to be able to describe the suppliers they should leverage, the distribution centers and/or manufacturing facilities they can rationalize, and the transportation routes they'll be able to optimize in double-quick time. Of course, they will also be expected to develop an aggressive, yet achievable, synergy target as quickly as possible.

Yet too few supply chain-intensive mergers fulfill their anticipated or desired business expectations. The days of producing simple economies of scale—adding Supply Chain Number One to Supply Chain Number Two—seem a thing of the past.

It will not get any easier to wring value from the union of two supply chains. No corporate function has grown in complexity in recent decades as much as the supply chain has. Take a look at your own organization. Does the supply chain fulfill international demand? Is it handling inbound goods from international sources? Does it process duty obligations on imports? Is it using more than one modality to distribute or receive goods? Does it involve decision-support technology to manage purchased transportation? What about a multi-national network of warehouses to deploy goods in the marketplace? How reliant is your organization on third-party logistics providers? Do you struggle to integrate your technology systems with those of your supply chain partners?

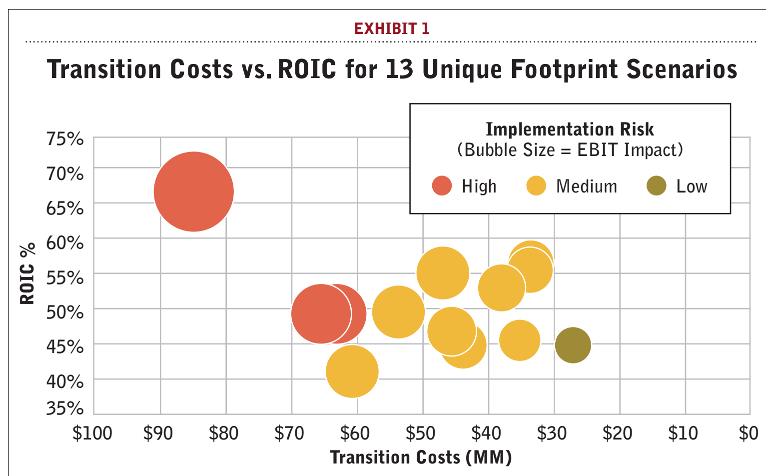
Chances are you answered "yes" to several of the questions above—and many more like them—especially if your company operates a global supply chain. But, when comparing supply chains even within the same industry or geography, it's not likely that there are common providers, technologies, or approaches—thus complicating a smooth and straightforward integration within the sector, let alone in any cross-sector merger.

Suffice it to say that supply chain leaders have plenty on their plates from week to week. So when they have to add "supply chain integration" to their long lists of to-dos, it is a struggle to find the time to do it well. Because very few have gone through multiple mergers, the processes needed to smoothly join two disparate operations are hardly second nature. Consequently, many leaders lack the requisite knowledge of how to lead mergers. Yet more often than not they are thrown into the fire and expected to produce results right away, with no disruptions in customer service levels. Quite the challenge indeed!

With that in mind, we have chosen to decompose the M&A process into its three main phases—pre-merger due diligence, post-merger integration planning, and post-merger integration—and to further break down each phase into the constituents upon which supply chain executives can act. Understanding these key phases will help them step up to the challenge of handling all of the complications that come when two or more highly complex infrastructures unite.

The Due Diligence Phase

Setting aggressive but achievable supply chain targets is the primary objective of the due diligence phase.



Whether or not the supply chain integration professional was involved, these targets will serve as the goals for the merger integration execution phases that follow. They will become the primary gauges of performance for the integration team as well as for the supply chain executive driving the union of the operations. In addition to including key savings and implementation cost transition targets, specific operational objectives have to be articulated as they relate to customer service, delivery performance, and inventory.

We have often seen mergers fail when the merging companies fail to spend the time necessary to really understand the joint opportunities available. In one recent case, the executive team at one acquiring company expressed the belief that the target company's manufacturing footprint could be halved. Unfortunately, that assertion wasn't grounded in the actual cost savings associated with a thoughtful integration; it was simply a function of the benefit that they believed would justify the deal.

To set appropriate synergy targets during due diligence, the supply chain leader must manage a process that seeks to: identify data-supported benefits; highlight the viable and most promising scenarios; and assess any impacts to customer service levels after the merger. The next step is to establish an aggressive yet realistic implementation plan—one that is time-phased and with all necessary resources pinpointed—in support of the chosen scenario and associated business case. Let's look at each process step in turn.

Conducting Detailed Data Analysis

It may seem blindingly obvious that detailed data analysis is needed during due diligence. But we draw attention to it because our experience indicates that it often gets short shrift (and not only in supply chain circles). Often, those driving the deal process want to identify synergy opportunities as quickly as possible, and this may come at the expense of appropriate diligence.

So we argue that data requests should be shared with the deal team as quickly as possible. That way, the senior deal-makers are given notice about what levels of analysis are needed in order to generate a reasonable estimate of impact. The analysis should cover all supply chain functions, including procurement, manufacturing, transportation, and logistics. It should also seek to uncover the true drivers of cost within each function and enable an "apples-to-apples" cost comparison between both companies.

Once this data request is shared with the deal team, each company should identify a "data request owner"—a professional who will be accountable and responsible for the prompt and thorough fulfillment of the data request. This will help achieve the second key objective of this phase: the analysis of various supply chain footprint scenarios to determine the trade-offs needed in different configurations.

Analyzing a Range of Footprint Scenarios

Though the deal clock ticks fast, it's important not to short-cut the development and analysis of scenarios that include various combinations of manufacturing and distribution locations. One way to juggle everything in limited time is to model the supply chain, an exercise that enables quick analysis of many scenarios.

In one recent merger, the supply chain integration team at a U.S.-based automotive parts manufacturer quickly analyzed more than 15 different scenarios, ranging from consolidating all current operations into one mega-plant in Mexico to keeping all current locations and modifying the production scope of each. For each scenario, the team modeled multiple dimensions of the supply chain, addressing the potential benefits associated with manufacturing labor (direct and indirect), overhead, salaried personnel, inbound and outbound freight, and distribution costs.

Earlier, the team had discussed the complexity of today's global supply chains, and talked about how this complexity often creates challenges when analyzing multiple footprint scenarios—particularly those involving multiple countries. By airing topics such as labor costs, land and property costs, taxes and currency differentials, and by understanding the trade-offs inherent in various freight options, the team was able to accurately estimate footprint costs for each scenario. It took just eight weeks

to go from scenario development to finished estimates.

Importantly, each scenario was evaluated across two dimensions: improvements in earnings before interest, taxes, depreciation, and amortization (EBITDA) and return on invested capital (ROIC.) Of course, these dimensions will likely differ depending on the specifics of the situation, but the key is to agree on the criteria for financial evaluation at the outset of the due diligence phase. (Exhibit 1 on p. 46 shows the evaluation done for 13 unique footprint scenarios.) Throughout the evaluation process, the integration team met continually with the deal team to understand their objectives and the key financial drivers behind the merger. In this case, the auto parts producer and distributor gravitated toward two recommended footprints: one that generated a relatively high EBITDA return and a lower ROIC, and the other with a relatively low EBITDA number but higher ROIC.

Understanding the Impact on Customer Service

This auto parts producer was savvy enough to know that making supply chain footprint decisions based solely on cost impact was a recipe for trouble. Regrettably, we regularly see senior supply chain managers minimizing or ignoring altogether the eventual impact of their integration decisions on customer service. During due diligence, the focus is almost always on cost savings; the assumption is that customer service is untouched.

In another recent situation, we worked with a consumer products distributor which, after a merger, ran three distribution centers (DCs) within a 150-mile radius. If the distributor had not reviewed the impact of its footprint decision on its service levels, the economics alone would have dictated that it reduce redundancy by closing at least one DC. But its integration team had found that each DC was operating in order to provide same-day delivery service to its customers, and closing any one of the centers would have led to the loss of at least 30 percent of revenue at the DC in question. The operational savings to be gained by closing a DC did not outweigh the potential loss of revenue and margin, so the distributor wisely designed the network to keep all three operational.

What Makes for an Effective Program Management Office?

In the best cases, program management offices (PMO) can add enormous value. But in the worst cases, they can simply be passive generators of reports. We have found seven factors that distinguish the best:

1. Well-qualified resource(s): As the old adage states: "You can't make a silk purse from a sow's ear." If a PMO function is not staffed with a capable and experienced project manager with domain content in the key areas under discussion, the PMO's effectiveness is likely to be limited at the outset. Project management skills are certainly important, but it's essential to have the insights to challenge a proposed course of action or to have equal standing with work stream leads in order to provide proper leadership and maintain momentum.

2. Project review cadence: The size and complexity of the program may affect the periodicity of meetings—or even necessitate a hierarchy of meetings. A steady pace and routine review is fundamental to keep programs on track, or to detect a need for intervention.

3. Top-down governance: Project management is sometimes synonymous with "resistance." A clear chain of command with unambiguous support from the top is a clear differentiator between effective, on-time projects and those more likely to falter or fail.

4. Target-driven goals: Most managers respond well to hard, quantifiable targets, which become the foundation for prioritization and the basis for assessing progress and success.

5. Tracking visibility: With targets comes a need for broad transparency. This also requires that the underlying data must be accessible in order to periodically refresh standings.

6. Broad reporting: It's not enough to set targets; you've got to track the results and promptly share the information—warts and all—with the appropriate stakeholders. Project interdependencies will often affect the timelines of other work streams. Project delays can mean redirecting resources in order to make up time—again, something to be reported.

7. Link to operational budgets: Projects cost money, take time, and consume scarce resources. By being able to assess the costs and benefits of any project over the course of a complex implementation, it becomes easier to detect and prevent potentially disastrous outcomes and to force the necessary discussions about alternatives.

We don't pretend that implementing these seven points will guarantee success, but we have found through experience that they will mitigate risks and lay solid foundations for the effective management of complex integration initiatives.

Developing the Integration Plan

Once the merger deal has been inked, it's critical to take the time to develop a comprehensive, achievable integration plan. Just as a pilot charts a flight plan prior to takeoff, establishing the integration plan ahead of time sets the course for the integration team throughout the merger. While high-level plans are often created during due diligence so the team can figure out the timing of costs and benefits, these plans are not sufficient to drive implementation. In our experience, mergers that go straight from due diligence to implementation, using the post-merger targets as the surrogate for the implementation plan, are less likely to generate the expected outcomes.

The most successful post-merger plans have the following common elements: They involve the establishment and operation of a program management office (PMO); they create "sending" and "receiving" project roles on the integration team; they include appropriate cross-functional representatives on the integration team; and they agree on financial and timing targets based on a comprehensive integration plan.

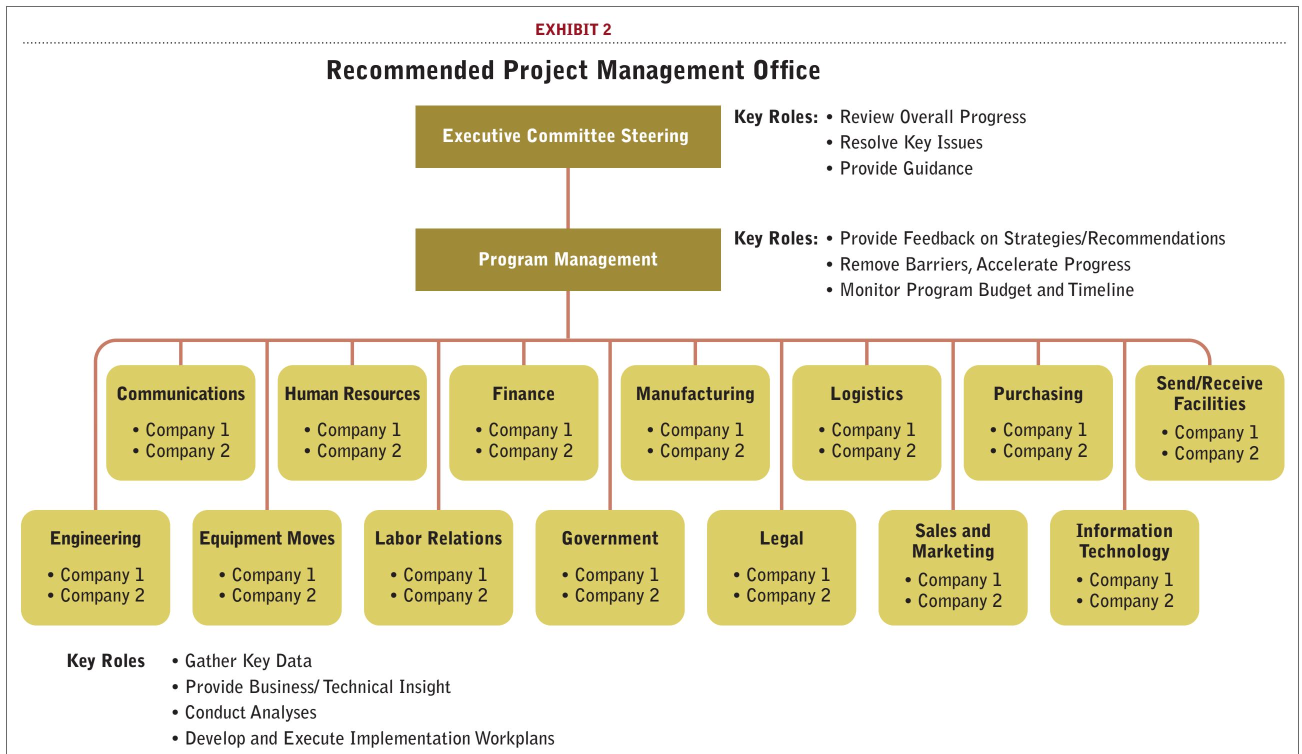
1. The Supply Chain Program Management Office. A program management office (PMO) helps to ensure that the complexities of today's supply chain integration efforts are dealt with and that the integration team is appropriately aligned with the other elements of the deal process. During the enterprise resource planning boom in the late 1990s and early 2000s, many chief information officers realized that a PMO structure was needed to maintain alignment across the company and to enable cross-functional communication. Similarly, complex changes in the supply chain will almost certainly affect purchasing, manufacturing, distribution, logistics, and sales, making cross-functional communication a must-have.

There's room in this article only for a high-level overview of what a successful PMO looks like. (See Exhibit 2.) It is spearheaded by an executive steering committee that helps to set strategic direction and resolve key cross-functional issues. The regular running of the PMO is typically led by a senior executive, who has primary responsibility for ensuring that the integration program delivers benefits on time and within budget. Various project teams handle the day-to-day projects. (See sidebar on "What Makes for an Effective Program Management Office?")

2. Creating "Sending" and "Receiving" Roles. When consolidating manufacturing and/or distribution facilities, production and/or distribution assets will be moved ("sent" from one facility and "received" by another). Because it is crucial to synchronize those moves, it's very important to identify the individuals who will serve as the "sending" facility lead and the "receiving" facility lead. Typically, these roles are filled by plant

EXHIBIT 2

Recommended Project Management Office



managers or DC managers.

This is another area that gets too little attention from many supply chain leaders, with the result that they have to deal with implementation challenges later. If either one of the facilities is out of sync—if, for instance, the sending facility sends assets to a facility that is poorly prepared to receive them—then lead times or line fill rates are sure to be compromised. The result is that customers are likely to feel the impact.

These "facility lead" roles become all the more important when cross-country collaboration is involved. In such situations, another key job for the leads is to fully understand customs, tariff, and tax implications and to ensure that the proper documentation is ready at border crossings. Manufacturing assets that are shipped cross-border are typically subject to special customs and tax provisions. And if the appropriate documentation is not available when needed, the equipment could be held up at a border for weeks, if not months.

3. Appropriate Cross-Functional Staffing. It is critical to resource the integration team appropriately. This can be difficult because those considered the most appropriate for implementing the integration are often the ones with the greatest demands on their time to begin with. While it's natural to want to put the "best and the brightest" on the integration team, the everyday needs of the business cannot be ignored. We have found that the best all-round results come from consciously balancing the priorities of merger integration activities with those of ongoing business activities. So in addition to involving all supply chain functions, it's really important to include representatives from sales to ensure that customer requirements are addressed throughout the integration.

4. Agreed-Upon Financial Targets and Timing. A key objective of post-merger planning is establishment of an aggressive yet achievable integration plan that contains agreed-upon financial targets. During this phase, best-practice integration teams typically set up financial tracking tools and processes to ensure that all key stakeholders are aligned on which financial targets must be tracked and how the financial baselines were established (see Exhibit 3). Establishing this framework at this point sets appropriate expectations for what will be tracked and measured; it's much easier to course-correct during planning than during implementation.

When setting these financial targets, it makes sense

EXHIBIT 3

Supply Chain Footprint Optimization Financial Return Summary

	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013	TOTAL
Ongoing Cost Savings						
Direct Labor						
Indirect Labor						
Salaried						
Variable OH (Excluding People)						
Fixed OH (Excluding People and Depreciation)						
I/B Logistics (Plants to DCs)						
O/B Logistics (To Customers)						
Net Ongoing Cost Savings (EBIT Impact)						
Transition Costs						
Cash Expenses						
Severance						
Hiring Costs						
Retention/Relocation Costs						
Equipment Relocation Costs						
Facility Wind-Down Costs						
Contract Termination Costs						
Lease Termination						
Temporary Incremental RM Shipping Costs						
Total Cash Expense						
Non-Cash Expenses						
Real Estate Impairment						
Equipment Impairment						
Total Non-Cash Expense						
Total Transaction Costs						
Return Summary						
Pre-Tax Return						
Invested Capital (Cash Expense)						
Return (EBIT Impact)						
ROIC						
Average Payback Method (Months)						

to include representatives from finance; they can help to determine how the targets are tracked and measured. The finance pros are also the right people to set the baseline performance against which all integration activities will be measured. In the example cited earlier—the auto parts producer—the project team included a key financial manager who helped with financial tracking and reporting.

Implementation of the Merger Integration

Even with a comprehensive integration plan in place, a talented cross-functional integration team on board, and clear financial targets set, there's no guarantee that the merger integration will be a success. In our experience, a successful outcome also depends on relentless focus on tracking and reporting results; continued attention to the day-to-day business; execution of a comprehensive plan for communicating with suppliers and customers; and decisions throughout the actual integration that are supported by data rather than "gut feel." Each factor merits a closer look.

Relentless Focus on Tracking and Reporting Results. By developing appropriate scorecards and regularly reporting on them, the integration team stands a far better chance of staying on track and staying true to its mission. And the company's senior leadership team will be getting the data it needs to track progress against achievement of the established synergy targets. The most successful integration teams don't simply track their own performance; they also report on business performance to ensure the integration activities aren't hurting customer service.

During a recent integration initiative with a large distributor, the integration team facilitated monthly financial reviews with members of the company's executive group. Spotlighting the overall performance of the business as well as their own progress, the team was able to show where the merger was having a positive impact and where there were opportunities for improvement.

Continued Attention to the Day-to-Day Business. Yes, we have seen instances where the merged entities are so focused on executing their internal plans that they lose sight of what is happening in the broader business. We have also seen circumstances where competitors are keenly aware that merging companies can lose customer focus during their integration activities. These competitors are poised to exploit any supply chain-related problems—poor product quality, slack fill rates—that loss of focus may produce. Losing sight of the big picture can also make it harder to attain integration synergy targets because they are based on annual plans that will suffer if sales decline, costs increase, or both.

Managing Comprehensive Communications with Suppliers and Customers. Time and again, we have seen situations where suppliers or customers are poorly informed about the consequences of a merger, and the results can be disastrous. The integration team has to make sure that suppliers and customers are continually aware of the supply chain changes to come. They can never assume that suppliers will hear about or read about changes in manufacturing locations, for example. It is the team's job to communicate these changes clearly—not simply sending a solitary e-mail or placing a phone call—and to work with suppliers to make sure they understand the consequences and will work to accommodate them. Purchasing contracts may need to be modified and appropriate IT system changes put into effect to accommodate these changes.

Data-supported Decisions Throughout the Integration. Integration teams have to expect the unexpected. At the very least, there will be factors that force deviations from the original plan. Decisions will need to be made quickly to preserve the integration timeline, and it's tempting to make these based on a "gut feel" or a "this is how we have always done it" sentiments. But that kind of decision-making can impede synergies and, in extreme cases, torpedo a merger. Here, the supply chain PMO can serve as an invaluable resource to ensure that all potential solutions were analyzed appropriately prior to making a recommendation.

Challenging Task Requires Support

With M&A activity expected to be a fact of corporate life in the next few years, business leaders will again turn to the supply chain as a prime source of synergies. Therefore, today's supply chain leader must be able to demonstrate the expanded skill set that makes it possible to handle all of the complications inherent in uniting two or more highly complex infrastructures, each with an entrenched way of doing things. The deconstruction of the M&A process detailed in this article is designed to help prepare supply chain leaders who face those challenges.

At the same time, those who drive the M&A deals from the top must recognize that supply chain integration, if it is to be done right, is a formidable exercise. If those top teams fail to give their supply chain leaders the support, data, and time needed to establish and achieve realistic synergy targets, they risk adding yet another anecdote on the growing pile of mergers that have failed to live up to their much-publicized potential.

Endnotes:

1 "Companies, Flush with Cash, Ready to Focus on Growth in 2012, According to an AlixPartners/EIU Survey," AlixPartners press release, January 19, 2012.

WMS Can Produce Big Logistics Benefits

APQC's data shows that organizations with Warehouse Management Systems have more efficient logistics processes and spend less on the logistics function overall, despite having higher costs associated with operating warehousing.

By Becky Partida, Knowledge Specialist-Supply Chain Management, APQC

Warehouse management systems (WMS) provide organizations with visibility into both warehousing and inventory. Increased visibility can lead to more efficient processing of received stock as well as more efficient order processing. These more efficient processes could, therefore, lead to faster delivery times and more accurate deliveries. Yet efficiency is not the only aspect of warehousing that can be affected by WMS. With efficiency comes the potential for decreased logistics costs.

To learn more about how organizations with WMS fare regarding logistics metrics related to efficiency and cost effectiveness, APQC looked at survey responses from its *Open Standards Benchmarking in Logistics*. Seventy percent of responding organizations have implemented WMS. Of these organizations, 72 percent report that their WMS is extremely effective in reaching their desired goals (see Exhibit 1).

Organizations that have not implemented WMS may wonder: Does investing in a data-intensive system like WMS raise logistics costs? Those that have implemented WMS but have not reached a high level of satisfaction with their systems may be concerned that their WMS will never provide a substantial return on investment.

To address these concerns, APQC looked at logistics metrics associated with efficiency and cost. The data shows increased efficiency in organizations with WMS, but the results related to logistics costs are mixed. These results reflect the complexity of adopting a WMS—a process in which several factors, including the unique circumstances of the enterprise, must be considered in order for the organization to obtain the full benefit of the technology.

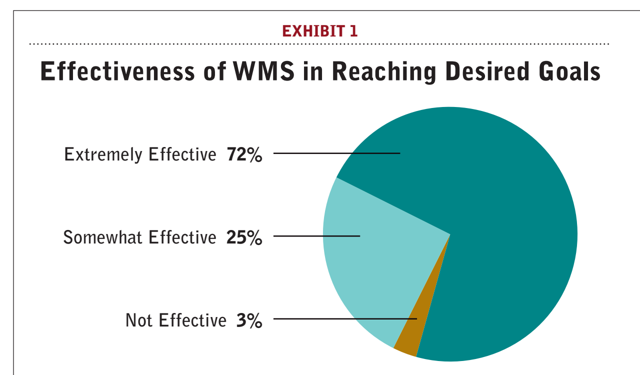
Warehouse Efficiency

APQC's data reveals that organizations that have implemented WMS have more efficient logistics processes than those that have not implemented WMS. In particular, organizations with WMS have higher perfect order performance as a percentage of all orders and a lower level of expedited orders (see Exhibit 2).

The superior performance on these two metrics by respondents with WMS could be tied

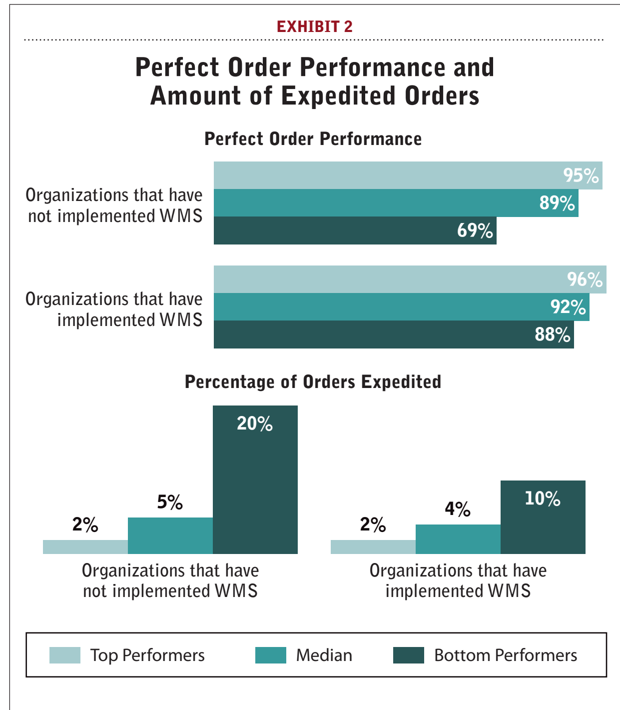
EXHIBIT 1

Effectiveness of WMS in Reaching Desired Goals



to the increased visibility into warehouse processes and inventory provided by the technology. The integration of warehouse functions into one system can enable warehouse staff to quickly pick and ship products that have been ordered. Inventory is accounted for in the system, which means staff can spend less time looking for products for an order. A centralized inventory system can also reduce the chance of a product being unavailable to send to a customer. This, in turn, can lead to an increase in on-time deliveries and a smaller percentage of expedited orders. Automation through a WMS can also increase the accuracy of the pick-and-ship process because staff knows exactly where to go to find a product within a warehouse.

The results of APQC's benchmarking survey in logistics are not surprising given the reputation of WMS for increasing logistics efficiency. However, WMS can be sophisticated and generate large amounts of data that must be monitored and controlled. How can this data expansion affect an organization's cost for warehousing? And is the cost worth it? APQC looked at additional results from its benchmarking database to determine whether the difference in costs for organizations with and without WMS were significant.



Logistics and Warehousing Costs

APQC found some surprising results when comparing the logistics costs of organizations that have implemented WMS to the logistics costs of organizations that have not done so. Exhibit 3 displays the cost of the logistics process as a whole and the cost of operating warehousing per $1,000 in revenue for both groups of organizations.

When calculating the total cost of logistics, APQC includes all personnel, systems, freight, overhead, outsourcing, and other costs related to warehousing as well as other key logistics processes such as outbound transportation, inbound material flow, reverse logistics, and logistics strategy. At the median, an organization that has implemented a WMS spends $3.63 less per $1,000 in revenue for the logistics process as a whole than an organization that has no WMS. Although this may seem like a small amount, for an organization with $5 billion in revenue this translates to a difference of $18.15 million per year.

Interestingly, organizations that have implemented WMS spend more on operating warehousing than those without WMS. APQC defines the total cost to operate

WhAt's Absent from your proCurement Strategy?
Most procurement strategies miss these three key components:
1. The **Training** your team needs to handle tough challenges
2. The **Tools and Templates** your team needs to do things the best way
3. The **Credentials** your team needs to get respect
*The All-Access Corporate Subscription from the Next Level Purchasing Association gives your team all of these things for one budget-friendly fixed price. Call us at 1-412-294-1990 or visit us online to get the **All-Access Corporate Subscription One-Pager** & learn more about how the All-Access Corporate Subscription fills the gaps in your procurement strategy.*
NEXT LEVEL PURCHASING ASSOCIATION
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warehousing as the total annual personnel, systems, overhead, outsourced, and other warehousing costs. At the median, an organization with a WMS and $5 billion in revenue would spend $50.65 million annually to operate its warehousing. A similar organization without a WMS would spend $33.7 million annually on the same process.

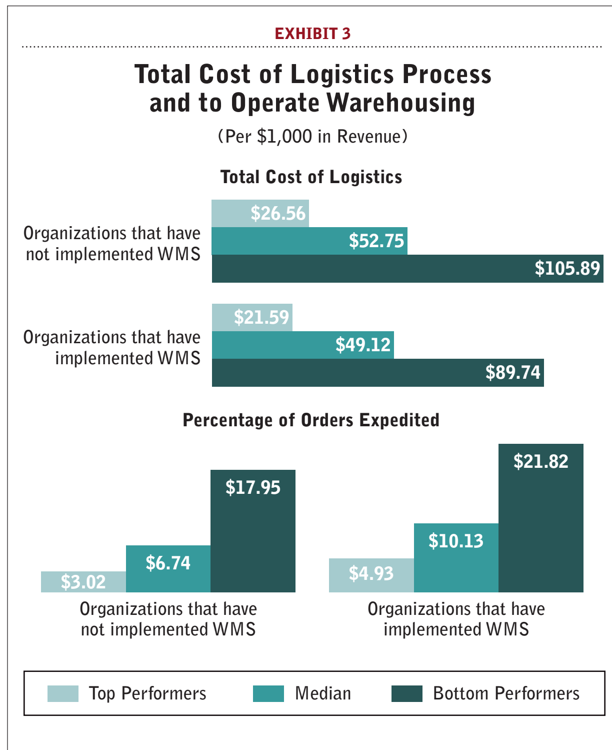
The fact that organizations using WMS spend less on logistics overall despite spending more to operate warehouses could indicate the following: While a WMS increases systems costs due to additional expenses related to implementing and maintaining the system, storing data, and training employees to use the system, the increased efficiency resulting from a WMS lowers costs in the rest of the logistics function. For example, if an organization using a WMS has better perfect order performance, this may reduce the amount of product flowing through its reverse logistics channels. This, in turn, lowers the overall costs related to the logistics function. Similarly, an organization with fewer expedited shipments saves money by using less expensive shipping methods while minimizing the need for logistics staff to rush to get shipments to customers.

Organizations without WMS may need more employees to perform activities that would otherwise be streamlined or automated with this technology. Without a centralized system for monitoring inventory and coordinating warehouse functions, employees are left to conduct these tasks manually. This additional work can lead to extra hours for staff and possibly a larger number of full-time employees needed within the logistics function, which would increase an organization's overall logistics costs. Having employees conduct warehouse tasks manually can also lead to higher error rates, less visibility into warehouse processes, and an inability to share information among warehouses or distribution centers. All of these factors can have a detrimental effect on logistics costs.

Looking at the Bigger Picture

APQC's data shows that organizations with WMS have more efficient logistics processes and spend less on the logistics function overall, despite having higher costs associated with operating warehousing. Many of the respondents to APQC's benchmarking survey indicate that they have already implemented WMS. Organizations that have yet to implement this technology, as well as those that have not obtained desired benefits from WMS, should consider several factors when looking to implement or modify a WMS.

There are many WMS products on the market today. Each organization needs to consider, for example, whether its unique circumstances warrant the adoption of a standalone WMS or if combining a WMS with an existing enterprise resource planning system would make more sense. Larger companies may have the available resources to implement WMS with other logistics processes aimed at efficiency, such as cross-docking or flow-through distribution. Another key consideration is the potential need for additional staff dedicated to the use and maintenance of the WMS. The potential need for additional technology and data storage necessary to support a WMS needs to be considered as well.



Organizations looking to increase the benefits obtained from their existing WMS should also consider whether existing systems place too many demands on their infrastructure. It is possible that they have neither the technological resources nor the staff necessary to get the full benefit from WMS. As with the implementation of a new WMS, organizations seeking to improve the performance of an existing WMS should investigate whether incorporating cross-docking or flow-through processes would improve logistics performance.

Warehouse management systems can potentially lead to big benefits for logistics functions. Finding the right balance between system requirements and benefits is imperative for organizations looking to get the most value from these systems.

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Transforming Procurement into a High Performer

By creating a high-performing function that is well-aligned with the business, has the right tools and strategies, and is mandated to deliver results, Best Buy is unlocking unprecedented value from procurement.

By Craig McKenney and Shivani Parekh

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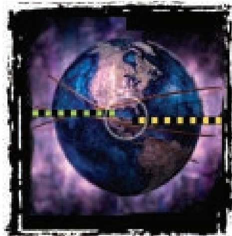

Two years ago, Best Buy's procurement function was performing reasonably well, delivering value of about 2 percent on the company's $4.5 billion indirect spend. The function had been outsourced for years and the retained procurement team was just five Best Buy FTEs. Steady state was working well enough, but pockets of spend were not fully addressed, and the relationship between procurement and the businesses needed improvement. Then, through a new strategy, procurement became part of a new Global Business Services (GBS) shared services structure. Through this approach, leadership felt the value being generated could be as high as 4 percent or 5 percent if procurement addressed the full sourcing and vendor management lifecycle and partnered more effectively with the business. Further, Best Buy saw that suppliers could be managed in a new and consistent manner to get maximum value and innovation.

Today, more than 100 people work in Best Buy procurement, and they are tightly partnered with the business, delivering over 200 percent more value than previously. Best Buy also reconfigured its outsourcing relationship, doubling the size of the offshore team, leveraging on-demand services and building new capabilities in the process, with those teams now working in support of the domestic Best Buy team. This article discusses five key lessons learned from this major transformation that supply management professionals may find valuable.

1. Reset the Partnership with Business Stakeholders

Before the transformation began, procurement operated with a transactional model under which five internal employees managed the outsourcer. Consequently, the company did not have enough leadership or internal talent to strategically partner with the business and, therefore, could not maximize value from the outsourcer. While Best Buy had not given up on outsourcing, the company believed it was time to develop a new procurement operating model.

A first step in the transformation was hiring internal talent to set a clear procurement mission and partner with the business to define a new operating model. Information technology (IT) was chosen as a first category to transform because IT leadership had a strong desire to optimize operating costs and was also moving from a highly outsourced model to having a larger retained organization. As both IT and procurement hired teams, those teams focused on optimizing IT vendor relationships. Initial results exceeded expectations and as a result, IT became the cornerstone of the new operating model.

Key Takeaways: Set a clear mission at the start of a procurement transformation, identify what "good" looks like, focus on an area of key opportunity, and deliver more than promised.

2. Define the Size of the Prize

The belief that procurement could deliver greater value was underscored by a spend assessment conducted at the beginning of the transformation by A.T. Kearney, Best Buy, and the outsourcer.

Under A.T. Kearney's direction, the parties reviewed Best Buy's total indirect spend, comparing pricing and contract terms for every category with best-in-class procurement functions. A clear 4 percent to 5 percent opportunity was defined (as hoped for) across the spend. Also, a multi-year roadmap was built while new teams were on boarded.

With the IT initiative well under way, Best Buy formed a second team to address a significant opportunity in the call center category. Moving beyond IT was critical to ensuring that the model would extend effectively across all spend and to gaining support for the next wave of the transformation. Call center was a success, and these early wins cemented the case for change.

Key Takeaways: Assess the savings opportunity with the business, and prioritize projects that highlight the transformation potential, ensuring that everyone succeeds.

3. Pick the Right Organization and Operating Model

At the beginning of year two, the team started working directly to rebuild other category teams—including marketing, properties, corporate services, and supply chain—while also executing a second wave of key IT initiatives.

Best Buy leveraged learnings from the IT and call center teams, A.T. Kearney, and the outsourcer to help redefine procurement's organizational design from top to bottom. A centralized model was chosen. The team also determined the operating model that would go hand-in-hand with the new organization. This model sets out the processes and procedures the teams need to follow and the role of the business in procurement's process, thus making them jointly accountable for performance and outcomes.

Key Takeaways: Leverage outside help to understand what best-in-class looks like, and tailor that to the company's culture and operating needs.

4. Don't Do it All at Once

At the beginning of the second year the procurement team laid out the remaining transformation with A.T. Kearney's assistance, and determined how to best capture value in parallel to building the new teams. The plan identified actions, timelines, resources, risks, and where Best Buy would use third parties.

The plan prioritized the second wave of hiring for non-IT categories and outlined targeted insourcing of activities. It also included the strategy for ensuring that internal stakeholders were on board with the change, committed to the organization and staffing model, and prepared to go after opportunities with the new teams. The procurement team also prioritized building new capabilities such as vendor management, e-sourcing, contract management, and sourcing support. And it de-prioritized items like a much-needed systems transformation until after the new team was in place and business relationships had been reset.

Key Takeaways: Put securing talent at the top of the list. Be sure to focus on projects that deliver the most value. Don't be afraid to delay portions of the transformation, even if they are critical long term.

5. Learn from Challenge and Change

A key value at Best Buy is to learn from challenge and change. After addressing IT, the team knew it had to do a better job with hiring, training, and business engagement to ensure success in the remaining categories. For example, the team made listening to stakeholders a priority and began conducting surveys with employees, business leaders, the outsourcer, and suppliers. The team also completed A.T. Kearney's Assessment of Excellence in Procurement benchmark study, giving it a baseline against which to measure future improvements.

Near the end of year two, with A.T. Kearney's help, Best Buy also went through a "fix-now, fix-later" exercise in which the procurement team identified specific areas of improvement. The team asked internal stakeholders and the now 100-plus procurement employees to draw on their experience within Best Buy and at other companies to put together a list of projects they felt procurement needed to address. Then the team asked the procurement employees to prioritize the 26 projects and play a lead role in accomplishing them.

Key Takeaways: Make change management a priority. Expect to make mistakes and adapt to those quickly. Listen to stakeholders, suppliers, employees, and partners.

Striving for Best-in-Class

Today, after two years of implementing these success factors, the team is about half way through this dramatic transformation. Before it began, procurement was a reactive function seen as non-strategic, without having the right internal talent, and even as a barrier to the business's need to move quickly. Today, it is a valued partner that can help the business move faster and achieve results as an enabler, partner, and high-quality service provider.

Best Buy's procurement organization is well on the way to becoming a high-performing function. Procurement is part of the company's Global Business Services (GBS) function, the organization delivering IT, procurement, and operational HR and F&A services to the company. The formation of GBS was a key enabler for the procurement transformation. The group is striving to become best-in-class—a goal the team expects to achieve in the coming years, with the help of A.T. Kearney, the outsourcer, key suppliers and, most importantly, its committed internal stakeholders and clients.

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SUPPLY CHAIN MANAGEMENT REVIEW

TOP 50 TRUCKING COMPANIES

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Strongest get SMARTER

The nation's top trucking companies share "high intensity" management teams, financial stability, and IT systems that afford "two-way communication" with shippers—and they're just getting wiser.

By John D. Schulz, Contributing Editor

Emerging from the three-year freight recession that slashed freight capacity and rates, the nation's top trucking companies view themselves as innovators, collaborators, technology leaders, and operational experts—not just as survivors of the Great Recession.

They also say that they've had to be part psychologist to retain drivers, part soothsayer to try and predict the future cost of fuel, and part accountant to keep a keen eye on ever-rising costs wherever possible.

Trucking insiders add that although all trucking companies basically use the same equipment over the same highways with the same pool of drivers, the Top 50 manage to differentiate themselves on many levels. According to John Larkin, longtime trucking analyst for Stifel Nicolaus, it starts at the top.

"When management intensity is high the organization pays attention to the details," says Larkin. "Management at the Top 50 is thinking 3 years to 5 years down the road to make sure that changes in the market and the industry don't leave the company up a creek without a paddle."

This annual listing of the nation's top trucking companies, compiled by leading trucking analyst firm SJ Consulting, runs the gamut of size and scope. There are units the likes of UPS Freight and FedEx

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TOP 50 TRUCKING COMPANIES

TOP 25 LESS-THAN-TRUCKLOAD CARRIERS—2011 REVENUES

(Includes fuel surcharges)

RANK	CARRIER NAME	2011 REVENUE ($MILLION)	COMMENTS
1	FedEx Freight	$4,710	Combined networks of FedEx Freight and FedEx National LTL
2	Con-way Freight	$3,197	Parent company revenues hit record mark of $5.3 billion in 2011
3	YRC Freight	$3,183	Formerly YRC National, includes YRC Reimer
4	UPS Freight	$2,299	Fastest growing division of UPS in 2011
5	Old Dominion Freight Line	$1,732	Most profitable public LTL carrier
6	ABF Freight System	$1,681	Profitable in 2011 after losses in 2009 and 2010
7	Estes Express Lines	$1,636	Largest private LTL carrier
9	YRC Regional	$1,554	Includes Holland, Reddaway, New Penn
8	R+L Carriers*	$1,207	Only LTL carrier with title sponsorship of a college bowl game
10	Saia Motor Freight Line	$1,030	Launched inside sales division to focus on small shippers
11	Southeastern Freight Lines*	$820	Largest private regional LTL carrier
12	Vitran Express	$686	Acquired Milan Express in Feb. 2011
13	Averitt Express	$557	2012 total company revenue could top $1 billion
14	Roadrunner Transportation	$467	Made four acquisitions of non-LTL companies in 2011
15	AAA Cooper Transportation	$435	Total company revenues grew 11% to $521 million in 2011
16	Central Transport International	$384	Consolidated 30 terminals in network in Nov. 2011
17	New England Motor Freight	$336	Division of the Shevell Group of Companies
18	Dayton Freight Lines*	$321	Largest year-over-year growth of private LTL carriers
19	Pitt Ohio Express	$305	Member of Reliance Network for national coverage
20	A. Duie Pyle*	$267	Opened 15th terminal in Sept. 2011
21	Central Freight Lines*	$207	Last formerly public LTL carrier to be taken private
22	Daylight Transport	$158	Light-asset with concentration on West Coast
23	Oak Harbor Freight Lines	$147	Oldest LTL carrier in the Top 25
24	New Century Transportation	$145	Light-asset load to ride hybrid LTL operation
25	Wilson Trucking	$137	Extended direct coverage to parts of Kentucky in Nov. 2011
	Total Top 25 LTL carrier revenues	**$27,601**	Note: Revenue for LTL operations only, unless otherwise indicated *Revenues primarily LTL and include less than ten percent for truckload and other services

Source: Company reports and SJ Consulting Group estimates. Prepared by SJ Consulting Group, Inc.

Freight that are subsidiaries of multibillion corporations; and then there are family- owned companies such as New England Motor Freight, a unit of the Shevell Group overseen by founder, Myron Shevell, a man with six decades of trucking experience.

But what all of these top operators have in common is operational excellence. Here's a look at what's making the Top 50 run like clockwork, and what shippers can expect from the best in class.

Common denominators

All trucking companies basically utilize the same trucks with the same population of drivers and run the same routes. Yet, there are key differentiators that set the best players apart from the rest. The nation's leading trucking executives recently opened up to explain what they do best.

Hank Schmidt, president of Con-way Truckload, says one common denominator among the Top 50 carriers is certainly their commitment to safety, among other basics. "It's the ABCs of doing things right," says Schmidt. "That encompasses compliance, having top-notch equipment, hiring the best people, all of that."

Trucking analysts comb all aspects of a carrier's operation and they say that they see certain values, an operational culture of excellence, and other expertise that sets the best apart from the rest. "They all have great information technology systems because you can't manage intensively without the information to make high quality decisions," says Larkin.

And if you dig a little deeper you also find that all

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TOP 25 TRUCKLOAD CARRIERS—2011 REVENUES

(Including fuel surcharges)

RANK	CARRIER NAME	2011 REVENUE ($MILLION)	SUBSIDIARIES / COMMENTS
1	Swift Transportation	$3,021	Revenue growth driven by +20% increase in dedicated
2	Schneider National	$2,600	Includes Schneider National, Schneider National Bulk Carriers
3	Werner Enterprises	$1,684	Includes One-way Truckload, Dedicated, and Cross-Border
4	Landstar System*	$1,660	Business Capacity Owner revenue only
5	U.S. Xpress Enterprises	$1,570	Includes U.S. Xpress, Xpress Global Systems, Total Transportation, Arnold Transportation, Abilene Motor Express, Smith Transport
6	J.B. Hunt Transport Services	$1,536	First carrier to top $1 billion in dedicated trucking revenue
7	Prime**	$1,206	First carrier to top $1 billion in temperature-controlled TL revenue
9	C.R. England	$1,007	Includes England North America, England Mexico, England Dedicated
8	Crete Carrier Corp.	$942	Includes Crete Carrier, Shaffer Trucking, Hunt Transportation
10	Greatwide Logistics*	$907	Acquired Overton Transportation in Jan. 2011
11	CRST International	$846	Acquired Specialized Transportation (STI) in July 2011
12	Knight Transportation	$796	Includes Knight Transportation, Knight Refrigerated, Knight Port & Rail Services
13	Ruan Transportation Management Services "	$672	Includes Ruan Dedicated Contract Carriage, Bulk Transportation
14	Covenant Transport Group	$618	Revenue decline of Covenant Transport division offset by 18% revenue increase for Southern Refrigerated Transport
15	Ryder Systems	$601	Dedicated Contract Carriage
16	Anderson Trucking Service	$576	Includes ATS, ATS Specialized, SunBelt Furniture Xpress, Midwest Specialized Transportation, Warren Transportation
17	Stevens Transport	$575	Equipped 100% of fleet with auxiliary power units
18	Celadon Group**	$566	Acquired assets of FFE's dry-van division, Martini Transportation, and Glen Moore in late 2011
19	Con-way Truckload	$532	Truckload division on Con-way, Inc.
20	Heartland Express	$529	Most profitable public truckload carrier
21	Mercer Transportation*	$468	Asset-light flatbed carrier. Largest year-over-year growth in Top 25
22	Marten Transport	$456	Largest public temperature-controlled carrier
23	NFI Industries	$452	NFI Dedicated. Total company revenue was $1 billion in 2011
24	Penske Logistics	$450	Total logistics revenues estimated at $2.6 billion in 2011
25	Interstate Distributor Co.	$444	Acquired by Saltchuk Resources in May 2011
	Total Top 25 truckload carrier revenues	**$24,713**	* Light-Asset Carrier ** Results adjusted to closer resemble calendar quarter

Source: Company Reports and SJ Consulting Group estimates. Prepared by SJ Consulting Group, Inc.

of the Top 50 have a culture that accepts and positively reacts to management intensity. To this point, Larkin adds that the best trucking companies offer "customer communication that is a two-way street in the spirit of collaboration, not the old take-or-leave-it approach under the regulated mindset of the industry prior to deregulation in 1980."

Today's trucking leaders say they have to be part crystal ball reader, part operational genius, and part sales person extraordinaire to survive in an industry where, even in the best of the times, the industry operates on razor-thin profit margins.

"We're always thinking ahead, trying to predict the future," says Steve O'Kane, president of A. Duie Pyle, a leading regional LTL company. "We have been correct often enough to remain not only viable, but healthy, debt-free, and profitable."

Then, there are the operational nuts and bolts—

the blocking and tackling—that all the top carriers share. This allows their asset utilization to be high through elimination of empty miles. They also run fleets that are relatively new and highly fuel efficient, allowing their asset life cycle costs to remain relatively low, according to Larkin. "And to fill the cabs of that equipment, they all offer top-notch driver recruiting, training, and retention programs," he adds.

And to top it off, the Top 50 have been able to keep their financial houses in order as well. This fact is especially important now, as the industry appears to be entering a period of tightening capacity and rising freight demand. At the same time, shippers with tight just-in-time inventory replenishment cycles simply can't afford to be without carriers with sufficient financial staying power, analysts say.

"Pricing is reflective of the service provided," adds Larkin. "Their balance sheets are not overly leveraged."

Staying alive to thrive

The fourth quarter of 2008 was generally considered the depth of the freight recession. Even top LTL com-

Biggest CSA problem areas according to carriers

The American Trucking Associations (ATA) says the issues cited by carriers as CSA problem areas include:

- Some states issue more tickets of a certain variety than do others. If a carrier disproportionately operates in such a state, his scores could be very misleading.
- Many small carriers have so few data points in the system that their scores are not revealed at all.
- One size does not fit all for hazardous materials. Right now, a carrier that spills a five-gallon can of paint is lumped together with a hauler of Class 1 hazmat with no differentiation noted.
- Failure to differentiate between non-avoidable accidents (such as being rear-ended) and those accidents where the truck driver is cited as being at fault.

—*Source: American Trucking Associations (ATA)*

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TOP 50 TRUCKING COMPANIES

panies such as Con-way Freight and FedEx Freight suffered their first quarterly losses in company history.

According to Larkin, most of the top 50 companies took four steps to remain in business and stay viable: they rooted out all excess cost; avoided "only-price-matters" customers; downsized the operation to fit the "new normal" demand; and slowed capital expenditure programs.

Some LTL carriers' profits were hurt during the downturn as they ratcheted up their discounting in an attempt to take advantage of YRC Worldwide's financial woes. During the depth of the recession, there was a concerted effort by some LTL carriers to "go for the kill" regarding YRC Freight. YRC lost in excess of $2.6 billion in the past five years, more than any trucking company in history, but it's still rolling along.

Like YRC, A. Duie Pyle was born in the 1930s but has remained steadily profitable even in tough times, according to O'Kane, its president. "In Pyle's 87-year history, the moves taken to remain viable have been countless," he says. "Our business and the environment in which we operate both change rapidly, so knowing how to navigate through those changes and making good predictions of what our company needs to do in the future is more of a process than a few landmark decisions."

Others agree that the tortoise wins this race, not the hare. "While a number of companies played pricing games with shippers to gain volume, UPS Freight's success was based upon building market share each year for the past six years," says Paul Hoelting, UPS Freight's senior vice president for sales. "It's success based on a consistent approach focused on value."

Chuck Hammel, president of Pitt Ohio, a top Northeast regional carrier, says that his company has made "plenty" of innovations since its inception in 1979. "Early on we pioneered next-day service when all of the competition was 2 days to 3 days," says Hammel.

"We were an early adopter of using the internet to conduct business, an early adopter of using on-board computing, the first LTL company to introduce mobile apps for smart phones, and the first company to knit together eight private companies to serve all of North America seamlessly (through its Reliance Network)," says Hammel. "In other words, we kept on the cutting edge of changes in the marketplace."

The current challenges

Today, according to analyst Larkin and carrier executives, there are three major issues that affect all the top trucking companies and their levels of profitability:

1. Fuel: The industry is poised to spend a record $170 billion this year on diesel fuel, which has stubbornly remained at the $4-a-gallon level and is threatening to hit $5.

2. Regulations: The new CSA regulations (Compliance, Safety, Accountability) as well as tweaks to the hours-of-service regulations threatens

Helped Wanted: Drivers

The push to recruit, train, and retain qualified truck drivers has never been greater among *Logistics Mangagement*'s Top 50 trucking companies.

Demographics, the Obama administration's regulatory crackdown on unsafe drivers, and tougher standards are all working against the industry. Still, Top 50 trucking leaders say that there are innovative and successful ways to stay ahead in the driver game.

"Retaining drivers has not been an issue as we pay well and have a very rich benefit package," says Pitt Ohio President Chuck Hammel. "But hiring new drivers is another story. There simply aren't enough quality drivers to fill the current needs in the industry."

It appears to be a simple equation. Those companies that are the most financially stable are able to pay their drivers the most, alleviating any shortages. "Sitting on top of the food chain we are really not that worried," says UPS Freight's Paul Hoelting. "As an industry, of course, there is worry. But as a specific carrier we are better prepared than our competitors."

A. Duie Pyle's Steve O'Kane has a simple formula: "Treat them right, pay them right, give them good and safe equipment, and continue to grow the business so they get the hours they want and need. Simple formula, but it all starts with treating them correctly."

Analyst John Larkin's solution to drivers is similarly simple: "Recruit and train drivers at a school or poach someone else's drivers." He advises that carriers make the job attractive with the newest equipment, best pay, and bonuses—and make sure drivers get enough miles yet get home on a regular basis.

—John D. Schulz, Contributing Editor

to drive up costs—even on the best-run companies.

3. Drivers: They are already in scant supply due to demographics (one in six truck drivers are 55 or older) and tighter scrutiny. Those companies with sufficient drivers are already being forced to pay more to retain them.

When it comes to fuel, Larkin advises carriers to deal with a national vendor, such as Pilot, to buy fuel at the cheapest possible price. Carriers should also implement all aerodynamic devices, including tractor aerodynamic package, mud flaps, side shirts, tail-cones. He adds that carriers should optimize to the most fuel efficient/low fuel cost route and implement a dynamic fuel optimization program.

"An efficient network and investing in technology improves productivity, which in turn lowers fuel consumption," says UPS Freight's Hoelting.

"We continuously study the fuel price environment," says Pyle's O'Kane. "We hold up to 500,000 gallons in inventory, buying and stockpiling on price weakness, drawing down inventories when prices spike. Additionally, we purchase future contracts, trying to predict price highs and lows."

The industry agrees that drivers ought to be trained to be fuel efficient. The American Trucking Associations (ATA) is on record as favoring speed limiters on new trucks, preventing them from exceeding 65 mph to 68 mph in order to save fuel.

All carriers utilize a sliding fuel surcharge, but not all shippers are paying the fuel surcharge, preferring to cap it at a certain level when diesel spikes. Increasingly, carriers are requesting those shippers pay more to compensate. As Pitt Ohio's Hammel says: "We're addressing customers that have less than standard fuel surcharges and are bringing those customers onto the full scale."

As for the Obama administration's push for greater truck safety, Larkin is advising carriers to wait until rules are published to comply—and be sure what the rules will be.

"There is no reason to be on the bleeding edge trying to be a hero anticipating rules coming down the pipeline, especially if the rules stymie productivity," Larkin says, referring to the still-unpublished final rule on hours of service.

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TOP 50 TRUCKING COMPANIES

Capacity and rates?

Capacity is slowly declining, carrier executives and analysts say. Lifecycle equipment ownership costs keep rising due to material price inflation, environmental rules, rising health care costs (at both manufacturers and carriers), safety, and fuel efficiency regulations. Fuel has steadily been increasing in cost, while driver pay and benefits will most certainly continue to rise.

Analyst Larkin says shippers could be facing what he calls "the mother of all capacity shortages." As demand continues to recover, Larkin says that there could be a capacity shortfall that would allow yields to rebound to rates not seen since the middle of the last decade.

All this adds up to bad news for shippers. Rates could rise 3 percent to 4 percent in less-than-truck-load (LTL), perhaps even higher in truckload (TL), and perhaps *even* higher on certain lanes where capacity is tightest, analysts and shippers say.

Industry leaders say flatly that price increases are inevitable in 2012, and beyond.

"Undoubtedly, increased regulations in the industry, including CSA, will drive up costs with those carriers ill-equipped to find efficiencies," says UPS's Hoelting. "Those increased costs will be passed on to customers."

"As the driver shortage becomes more severe, and it will, driver pay must increase," predicts A Duie Pyle's O'Kane. "As an industry, we're going to need to increase pay to attract the number of drivers we need for the future."

Pitt Ohio's Hammel says that he's "certain" that rates will go up in the near term. "However, rates can only go so high before a shipper starts to look at adding their own company trucks or look at dedicated trucking," he warns. Once some large shippers switch away from common carrier to private or dedicated carriage, Hammel says, that will free up capacity for the rest of the market.

TL shippers could be in for even higher rates due to their longer lengths of haul and higher percentage cost of diesel. Cass Logistics, which pays around $17 billion in freight bills annually, says its TL pricing index rose 8.6 percent last year and could be in for a similar rise this year. TransCore, another bill payment services company, says that its TL contract rates rose 6.5 percent last year while spot rates rose 7.4 percent.

All this bodes well for carriers who have survived the worst economic downturn in 70 years. As Con-way Truckload's Schmidt says: "Market forces have dictated the survival of the fittest. The ship rises for those who have weathered the storm."

—John D. Schulz is a Contributing Editor to SCMR

February truck tonnage up 5.5 percent annually, says ATA

Seasonally-adjusted (SA) truck tonnage in February was up 0.5 percent after a revised 4.6 percent (from 4 percent) January decline and a 6.4 percent December increase. December represented the biggest annual monthly gain since July 1998 at 10.5 percent. February's SA was 119.3 (2000=100) and was ahead of January's 118.7 and 5.5 percent better than February 2011.

February's month-to-month increase was its sixth in the last seven months, according to ATA data. And the SA index is up 4.3 percent year-to-date compared to the first two months of 2011.

The ATA's not seasonally-adjusted (NSA) index, which represents the change in tonnage actually hauled by fleets before any seasonal adjustment, was up 1.3 percent in February from January at 112.9. It was below December's 116.4. Compared to February 2011, the NSA was up 9.7 percent.

Some analysts maintain that the NSA is more useful because it is comprised of what truckers haul. As defined by the ATA, the NSA index is assembled by adding up all the monthly tonnage data reported by the survey respondents (ATA member carriers) for the latest two months. Then a monthly percent change is calculated and applied to the

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index number for the first month.

"Fleets told us that February was decent and that played out in the numbers," ATA Chief Economist Bob Costello said in a statement. "I'm still expecting continued truck tonnage growth going forward. Rising manufacturing activity and temperate consumer spending should be helped a little from an improving housing market," he said.

Carriers continue to tell *LM* that demand and tonnage remain fairly decent, especially when taking the slowly recovering economy and seasonality components into account.

Strength in manufacturing, somewhat steady retail sales, and signs of a slowly improving housing market are all serving as drivers of truck tonnage volumes. But unlike the past two years there does not seem to be a significant inventory rebuild in place.

But retail inventories have been lean since well before the holiday shipping season, due to the fact that retailers don't want to be caught with extra stock following the holidays (which happened in early 2009). This, in turn, forces them to sell leftover stock at a sharp discount in the first quarter.

What's more, carriers have said that although capacity is tight, they are well-positioned to take on more capacity during the first half of 2012 as they rebuild inventories and the economy slowly improves.

"Since bottoming out in the summer of 2009, tonnage is up a very robust 18.2 percent," Costello said in an ATA video. "Manufacturing has really been driving a lot of this tonnage increase, but there are also signs of life out of the housing sector that really helps flatbed carriers."

Costello said he is concerned over fuel prices, explaining that as consumers spend more on fuel, it leaves less to spend elsewhere. But, he said, that has been balanced out in recent months with employment gains.

Stifel Nicolaus analyst John Larkin observed in a recent research note that freight volumes should grow slightly faster than freight hauling capacity, as carriers will likely hold capacity in check until adequate margins are earned to justify reinvestment in their fleets. He noted this is sorely needed after the industry extended its average fleet age to near record highs through the great freight recession.

—By Jeff Berman, Group News Editor

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FTR Trucking Conditions Index down in February

Freight transportation consultancy FTR Associates reported that conditions affecting the trucking market in its Trucking Conditions Index (TCI) were down slightly in February from January.

The TCI, which reflects tightening conditions for hauling capacity and is comprised of various metrics, including capacity, fuel, bankruptcies, cost of capital, and freight, was 5.9 in February, down from January's 6.1 and December's 7.0.

January marked the end of a three-month growth streak for the TCI.

According to FTR, a TCI reading above zero represents an adequate trucking environment, with readings above 10 indicating that volumes, prices, and margins are in a good range for carriers.

"February is normally the softest month of the year in terms of trucking demand. Reasonably favorable conditions for truckers during the winter slack season bode well for later in the year, as demand increases seasonally to more normal levels," said Larry Gross, FTR senior consultant, in a statement. "We expect pricing power to remain squarely on the side of the carrier in 2012."

FTR officials said that the coming months are expected to show sequential strength through the remainder of 2012, with trucking freight volumes expected to grow at rates of 4 percent or better, which in turn will put pressure on available capacity while maintaining pricing power.

As *LM* has reported, there are multiple factors at play which are positive for carriers, including high fuel prices, fairly tight capacity, a limited driver pool, and regulations like CSA and HOS (set to kick in next year) working in tandem to create an environment in which many shippers are chasing the same carriers for freight.

In a previous interview, Gross said that even with mild economic growth, overall conditions are likely to be tempered for shippers, adding that if the recent spate of good economic news translates into more robust economic growth, capacity would tighten significantly and greater upward pressure on freight rates will come as a result.

The firm also said that the rebounding U.S. economy is expected to produce at least a 3.9 percent gain in truck freight that would top overall GDP performance.

—By Jeff Berman, Group News Editor

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ATA pushes tax swap, asks for 6.3-cent hike in federal diesel tax

In an unusual move that is likely to be dead on arrival in an election year, the trucking industry is asking Congress to raise the federal fuel tax on diesel in exchange for dropping a 12 percent federal excise tax on large trucks.

The plan could cost shippers higher freight rates and fuel surcharges, yet the American Trucking Associations (ATA) is pushing for the unusual swap in an attempt to provide a more stable source of revenue for improved infrastructure spending.

The ATA is backing a bipartisan bill in Congress that would provide what the trucking lobby calls a "modest" increase in diesel fuel taxes. The bill—H.R. 4321—has been introduced by Reps. Jim Gerlach (R-Pa.) and Earl Blumenauer (D-Ore.) and endorsed by the ATA. If adopted, new trucks will be more affordable in this country, but diesel fuel taxes would increase.

The federal tax on fuel—23.4 cents for diesel, 18.4 cents for gasoline—has been unchanged since 1993. Because of inflation, the federal fuel tax does not provide enough funding into the Highway Trust Fund, which repeatedly has had to have an injection of funds from the general treasury the past few years in order to remain solvent.

The bill is considered a long shot to pass in an election year, meanwhile Congress has been unwilling or unable to find a stable source of funding for a long-term highway bill. Instead, it recently passed the ninth short-term extension, continuing funding at the old level for the next six months.

ATA President and CEO Bill Graves calls the fuel tax for excise tax swap a good deal and a tradeoff the trucking industry seems willing to make. Graves said that the proposal "would not only reinforce the ailing Highway Trust Fund, but would provide a boost to U.S. manufacturing and speed adoption of environmentally friendly technologies."

Defying conventional wisdom which says no tax increase ever passes in an election year, Graves said the Gerlach-Blumenauer proposal is exactly what the country and the trucking industry needs at this time. "It is exactly the kind of pro-growth, deficit-trimming legislation that lawmakers should be looking at as they seek to address our nation's economic woes," Graves said in a statement.

—John D Schulz, Contributing Editor

Teamsters sign off on proposed change of operations for YRC Freight

YRC Freight, a subsidiary of less-than-truckload transportation services provider YRC Worldwide, had its proposed change of operations plan approved by the Teamsters Union, according to a trucking industry message board and Teamsters for a Democratic Union (TDU).

YRC first rolled out its proposed change of operations plan in early February. The proposed operations changes were initially reported on a trucking industry message board, which had YRCW documentation regarding this initiative.

Among the various action items YRC proposed are:

- reducing corridor hubs and freight handling;
- eliminating and reducing end of line road domiciles;
- eliminating a distribution center;
- reversing specified road primaries;
- closing a sleep road domicile; and
- adding additional sleeper runs to current sleeper domiciles.

YRC said in a statement that the design of the present day freight handling structure within the YRC network is to handle in excess of 70,000 shipments on a daily basis, with a marketing strategy to provide same day, next day, two day, three day, and four day service.

"The reality of the economic climate is that the company is handling, on average, 48,000 shipments per day with a linehaul network domiciled at approximately 150 locations," said YRC. "The vast number of these domicile locations and the excessive number of freight re-handle locations must be restructured to continue the strengthening of the company's financial position to better provide job security to its employees while at the same time growing the business and increasing employment opportunities. This change of operations request is also intended to return YRC to what it does best—provide world class service to its customers in the 500 mile to 3,500 mile market."

TDU reported that the scheduled implementation

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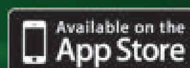

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date for the change in operations is April 8.

As per the conditions of the agreement, which were outlined in Teamsters documentation on a trucking industry message board, Gordon Sweeton, Teamsters Vice President, Central Region, stated various conditions of the approved operating agreement to Teamsters' members.

Those conditions include: that employees applying for openings at sister companies will not be turned down as long as they have the ability to pass the pre-employment drug screen and satisfactory driving record and do not have extensive absenteeism; is not in violation of any of the terms of the National Master Freight Agreement or any of its respective Regional Supplemental Agreements; and that YRC will not divert any freight to sister or subsidiary companies.

YRCW executives were not available for comment, but a company spokesperson told *LM* that: "The change was heard and the company is waiting on the official decision from the Committee."

In a recent interview with *LM*, YRC Freight President Jeff Rogers said that by focusing on what YRC Freight does really well—long haul in the 500 mile to 3,500 mile market—and focusing on two- and three-day transit times and taking handles out and doing more direct loading, it will speed up its service and thus reduce freight claims and freight handling.

"It is, in a way, about de-emphasizing or not doing next-day as much, which is not a core focus, and we want to focus on what we do better," said Rogers.

He explained that YRC has short-haul covered well with its New Penn, Holland, and Reddaway regional LTL units, which he said are the best next-day carriers in their footprints and the best use of company assets.

YRCW CEO James Welch recently told *LM* that he was confident that the changes would be approved.

When Yellow and Roadway were initially integrated in 2009, Welch said that the network was not designed as effectively or as efficiently as it needed to be.

"We are reducing our handling and speeding up transit times and speeding up the two-to-five day service lane business," said Welch.

—By Jeff Berman, Group News Editor

Offer to FMCSA: "Come ride in our trucks"

Con-way Truckload President Herb Schmidt has a standing offer for bureaucrats at the Federal Motor Carrier Safety Administration (FMCSA) who want to tweak the current truck driver hours-of-service (HOS) regulations: Come ride in our trucks.

"My hope is that common sense prevails on HOS," says Schmidt.

"These are well-meaning people writing these regulations, but they need to get out from behind their walnut desks and experience life on the road for one week under current regulations and under their proposed regulations. It will become very clear to them that they have made a significant mistake."

Washington bureaucrats are threatening to tweak the so-called "34-hour restart" provision in a way that carriers say would increase their costs, cause them to hire more drivers, and run more trucks and would not meaningfully increase truck safety.

"Unless there's a hidden agenda, the current HOS rules are working just fine," says Schmidt, citing statistics that show that trucking has never been safer since the current HOS rules were adopted in 2004.

In order to increase the awareness of the industry, Schmidt has a standing offer for FMCSA officials to take a ride in any Con-way Truckload vehicle for a week.

"We can increase safety and productivity if we work together," he says. "We have to work at creating efficiency, not inefficiency."

—John D. Schulz, Contributing Editor

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