



Linking the CFO to Supply Chain Execution

by Mahesh Rajasekharan, Ph.D

CFOs are ideally positioned to grow market share and profits through strategic supply chain management.

As global competition intensifies at an increasingly rapid rate, savvy companies are staying ahead by turning lean and agile supply chain management (SCM) from a service utility to a strategic asset—a functional part of the company that also positively affects the bottom line. While it is becoming generally accepted that flexibility, real-time responses and agility are necessities for success in supply chain management today, few companies have recognized that the key to implementing such a system as a strategic asset is already right under their noses.

To use supply chain management strategically, a company needs to have a good overview of its total costs and sources of value to align business strategy with the supply chain. A company must also close the gap that commonly exists between the lip service paid to the importance of supply chain management and actually allocating the resources and experience necessary to optimize supply chain management performance. Fragmentation and decentralization among various supply chain processes too often hamper efficient product flow in today's global business environment. Also, no system can achieve all its potential without the proper metrics to measure and fine-tune performance.

You may think the odds of finding one person proficient in a range of tasks this broad would be next to nil. Surprisingly, he or she is already part of your company, occupying the Chief Financial Officer's office. More and more companies are recognizing that the CFO's skill set

is a competitive asset in its own right, and well suited to employing the supply chain to strategically cut costs and increase profits. In fact, CFOs lead SCM at Home Depot, Sun Microsystems and Delta Airlines.

Today's CFO is charged with reducing cash-to-cash cycle times, achieving profitable growth, delivering predictable revenue and reducing the company's risk profile. As the economy tightens, there are few places for the CFO to turn to affect the bottom line.

Innovative CFOs are recognizing that they are in a unique position to lead a company's supply chain management. They serve as an unbiased entity with no emotional affiliation to the current set of processes, and their top responsibility lies with the financial success of a company. Their financial training gives them a solid analytical foundation from which to evaluate the effect of system-wide changes on the bottom line.

Many profound changes in a company's supply chain management processes require strategic financial bets that a CFO is in the best position to make. Most companies lack centralized global supply chain management processes, resulting in fragmented governance and control, and inefficient sales and operations planning (S&OP) processes. The CFO's position and analytical skills are a natural fit to drive cross-functional execution in S&OP process management.

It's not just a good idea to have the CFO involved in

SCM. Unbeknownst to many, Sarbanes-Oxley (SOX) indirectly demands it. SOX and other compliance and risk management responsibilities require the public company CFO to have a tighter control over supply chain performance and execution. Section 409 of SOX requires public companies to disclose rapidly, and on a current basis, any changes in the financial condition of the company—a challenging task given the complexities and changing nature of today's global supply chain.

For visionary CFOs, however, SOX compliance represents a unique opportunity to pursue best practices in supply chain planning and risk management integrated with corporate governance. The requirement to detect and report on material changes in a company's financial performance creates an acute need to have complete visibility into the financial supply chain, including up-to-date changes in inventory value and other liabilities and contracts.

Merging the financial plan into SCM helps both

The rapidly increasing pace of business requires tight alignment between financial and supply chain management decisions. Short product life cycles and changing consumer demand—particularly characteristic of the high-tech industry—mean companies whose supply chains aren't in synch with their financial planning are less likely to make their numbers.

For example, a semiconductor company recently implemented solutions to manage integrated sales and operations planning, thus tying the supply chain with financial management. This company has world-class supply chain management processes and centralized supply chain management governance, and its SCM team is financially savvy and engages in regular meetings with the CFO and controller. Team members are prepared to make management decisions based on forward-looking demand-supply (capacity) data matched with financial ratio projections.

Accordingly, the SCM team members decided to ramp down factory output at one of the company's high-volume factories after peak Christmas shipments had been completed. S&OP planning intelligence had indicated that additional shipments would lead to excess inventory at distributor- and supplier-managed hubs, which could create future price erosion and inventory write-offs. Previously, they could not have made such a timely decision because the factory wanted to maximize throughput and utilization, and supply chain managers did not want to risk reduced supply during the peak Christmas season.

Integrated financial and supply chain management gave them the ability to determine the risk level and positively impact the bottom line.

Short-life-cycle product companies serving volatile

markets such as high tech and consumer electronics have difficulty meeting revenue projections without the ability to generate forward-looking financials based on product demand-supply fluctuations. Yet many of these companies still have not taken the step to bring together the CFO's office and SCM.

For example, in the cell phone industry, leading companies like Nokia, Samsung, Motorola, LG Electronics and others collectively introduce 20-40 new cell phone models (including technology variants) every six months. These products typically have a 3-5-1 product life cycle, taking about three months to design the product, five months to launch and sell, and one month to liquidate. The exact duration in each life-cycle phase varies across different product types, but the relative ratio stays fairly constant.

Cash flow is initially negative during the design phase, starts turning positive during the selling phase, and most companies become cumulatively positive in cash flow only when they get to the end of the selling phase. (Many companies slip back to a cash-flow-negative position due to issues such as price protection and disposal costs, but this can be avoided if managed correctly.)

With short life cycles and volatile markets, effectively managing product margins by considering various cost components across the product life cycle can lead to sustained operating profitability and positive cash flow. Through proactive life-cycle cash-flow analysis, companies can implement timely decisions that lead to more products finishing in the black and fewer products dragged back into red at the end of their life cycles. Supply chain management can make a difference in these businesses by coordinating product transitions and new product introductions aligned with end-to-end supply chain capabilities and financial indicators of demand, such as point-of-sale information from retail channels.

How effective SCM benefits the CFO

Effective supply chain management addresses the four key issues that follow:

1. Reducing cash-to-cash cycle times

Through perfect orders and accurate customer invoicing, companies can optimize cash collection and shorten cash-to-cash cycle times on the accounts receivable side.

On the other side of the cash cycle, proactive use of accounts payable to manage uncertain international lead times helps minimize growing cash cycle time. By basing invoicing on proof of delivery and making payments to suppliers at the last possible moment, CFOs can maximize the cash assets in the company.

2. Reducing the company's risk profile

Effectively optimizing total landed cost, despite global supply chain uncertainties, helps in the management of

corporate budgets and gross margin erosions. Companies frequently consider the lower unit costs in choosing global suppliers and fail to consider the uncertainties inherent in global supply chains. Several factors impact the total landed cost, among them:

- Elevated transportation costs due to increased fuel surcharges and specially expedited shipping needed to offset delays from outsourcing
- Longer lead times that require more in-transit inventory and reduce responsiveness
- Lost business due to delays in custom clearance or a sudden surge in demand that could not be immediately fulfilled
- Increased inventory holding costs due to higher inventory needed to offset these risks

3. Achieving profitable growth

As CFOs experience the impact that strategic supply chain management has on the financial picture, they see they must not only focus on cost reductions but also on growing revenue and market share. The majority of supply chain organizations can measure and model cost reductions, but only the best can quantify the supply chain's impact on revenue. The CFO is in an excellent position to analyze and quantify the financial tradeoffs of supply chain investments to improve revenue and market share.

4. Delivering predictable revenue

The financial community expects CFOs to deliver predictable revenue and profits on a continuous basis. A majority of the future supply and demand information the CFO needs to fulfill this responsibility lies within the supply chain. In addition, the CFO's ability to execute the financial plan is tied to the ability of the supply chain to deliver on the company's business plan.

Supply chain management programs can reduce working capital requirements through effective supplier-managed inventory programs, multi-echelon inventory optimization techniques and supply chain visibility linked to six sigma programs. These programs offer ways to free up cash flow and reduce current assets tied into operations.

CFOs can clearly see the relationships among the projected financial statements, financial metrics such as return on assets and return on equity, and operational metrics impacted by supply chain performance. Therefore they are positioned to make the proactive investments and decisions required to make the business plan happen using their greatest strategic tool—the supply chain.

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Major Supply Chain Risks Companies Should Consider

Regulatory

- SOX compliance: Lack of network visibility for tracking and reporting material exposure
- RoHs/WEEE compliance: Lack of uniform quality assurance across the global supply chain for all supplier processes and products, from raw materials to finished goods

Customer-Facing

- Shorter product life cycles: Slow-response time due to an outdated, poorly integrated or inadequate IT infrastructure

Contractual

- Inadequate documentation of ownership and usage rights for products and components

Inventory

- Overvalued channel inventory
- Lack of visibility into inventory channel
- Negative impact of aging inventory on demand matching

Brand

- Poor visibility into global gray market
- Counterfeiting exposure due to inadequate track-and-trace capabilities

Outsourcing

- Invalidated pricing for outsourced components
- Supply disruptions



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