Gartner Research

Focus on Operating Outcomes, Not Reduction Targets, to Optimize Supply Chain Cost

Paul Lord, Senior Director Analyst

24 May 2019
Focus on Operating Outcomes, Not Reduction Targets, to Optimize Supply Chain Cost

Published: 24 May 2019   ID: G00382831

Analyst(s): Paul Lord

Supply chain and business roles must align and collaborate around operating outcomes, rather than reduction targets, to optimize total cost. Supply chain leaders can use this research to adjust how they engage stakeholders and propose initiatives that achieve breakthrough cost improvements.

Key Findings

- Reduction targets for cost and inventory create apprehension and resistance among stakeholders, inhibiting the collaboration and innovation required to drive and sustain improvement.
- Attempts to reduce cost within individual sites and functions put quality and service at risk, or create constraints that limit improvement potential.
- Companies often pursue too many initiatives simultaneously without investing in the talent and technology required to enable improved performance.
- Supply chain organizations focusing on improving strategically aligned outcomes have demonstrated that trade-offs among cost, service and quality are not always necessary.

Recommendations

Supply chain leaders pursuing cost optimization should:

- Drive collaboration and innovation for improved performance by aligning multiple functions around cost-optimized operating outcomes.
- Enable decisions by defining metrics and developing cost analysis models that align to the scope and performance objectives of specific operating outcomes.
- Justify investments by proposing initiatives based on their potential to impact performance and deliver improvement to specific operating outcomes.
Table of Contents

Analysis..................................................................................................................................................2
    Big Picture Approaches Are Useful but Not Fully Actionable.......................................................... 4
    Focus on Efficient Operating Outcomes to Sharpen Focus and Align Stakeholders...........................6
    Respond to Short-Term Pressure by Clarifying Outcomes.................................................................9
    Growth Strategies and Events Complicate Cost Optimization........................................................... 9
Gartner Recommended Reading.............................................................................................................10

List of Figures

Figure 1. Cost Management Remains Short Term and Functionally Focused................................. 3
Figure 2. Five Levers for Supply Chain Cost Optimization................................................................. 5
Figure 3. Align Stakeholders on Efficient Operating Outcomes........................................................... 6
Figure 4. Optimize Operating Outcomes to Support Strategic Value Imperatives.............................. 7

Analysis

Professional golfers long ago learned to focus on the process rather than the result, as it gives them both a plan and positive focus before each shot, while also letting them visualize the shot’s trajectory before taking their swing. Without this approach, self-doubt, negativity and consequences of bad shots can creep in.¹

Top-down cost reduction targets cause similar negativity within organizations. Resulting pressure and conflict limits a supply chain’s ability to meet its full performance potential. Figure 1 presents results from a recent Gartner survey,² elaborating on top challenges faced by supply chain leaders in their pursuit of cost optimization. Short-term cost pressure cultivates skepticism surrounding long-term business value being overlooked.
Logistics leaders who completed the survey also cited challenges with achieving ongoing cost reduction targets within their function while, at the same time, struggling to acquire sufficient talent. This illustrates the paradox of taking functional approaches to cost improvement. They place isolated pressure on operating functions, such as logistics, which are primarily responsible for the reliable, safe and compliant delivery of materials to warehouses, factories and customers. At the same time, these functions have limited direct influence over distribution plans and commitments to customer orders that drive operating activity.

These narrow approaches create sentiments that range from dejection to resignation. At best, there is superficial compliance in the form of routine diligence using the most obvious tactics. Leaders know their efforts will create skepticism within the organization. Stakeholder reactions can range from passive resistance to open conflict. Even so, the assigned targets leave them no choice: their hands and feet are active, while their hearts and minds are elsewhere.

Cost reduction attempts are further stifled by simplistic approaches that overlook complex impacts of constraints, variability and system interdependencies. Gartner has observed examples that include:
Logistics leaders who completed the survey also cited challenges with achieving ongoing cost reduction targets within their function while, at the same time, struggling to acquire sufficient talent. This illustrates the paradox of taking functional approaches to cost improvement. They place isolated pressure on operating functions, such as logistics, which are primarily responsible for the reliable, safe and compliant delivery of materials to warehouses, factories and customers. At the same time, these functions have limited direct influence over distribution plans and commitments to customer orders that drive operating activity.

These narrow approaches create sentiments that range from dejection to resignation. At best, there is superficial compliance in the form of routine diligence using the most obvious tactics. Leaders know their efforts will create skepticism within the organization. Stakeholder reactions can range from passive resistance to open conflict. Even so, the assigned targets leave them no choice: their hands and feet are active, while their hearts and minds are elsewhere.

Cost reduction attempts are further stifled by simplistic approaches that overlook complex impacts of constraints, variability and system interdependencies. Gartner has observed examples that include:
• **Price over value.** Supplier substitution or contract renegotiation to obtain price concession sacrifices elements of quality, service or flexibility, which impairs the nature of the network response. One common example is contract manufacturing arrangements with minimum volumes and long commitment lead times — increasing the difficulty to optimize inventory and service levels.

• **Shifting fixed costs.** Outsourcing, offshoring or contract labor are employed to reduce the overhead costs attributed to full-time employees. This creates the need to develop new capabilities for managing service providers and may not even reduce total cost — impacting both work quality and organizational morale.

• **Supplier financing.** Many purchasing strategies target the extension of payment terms or force suppliers into consignment arrangements. Doing so puts the reliability and security of supply at risk — particularly for suppliers with weaker financial health than their customers.

• **Inventory reduction.** Inventory is often confused for cost, and cash flow impacts are not always distinguished between fixed cost absorption or allocation. While inventory has a cost, the full range of its contribution to efficient, reliable supply is not fully appreciated. Cycle stock supports the leverage of scale to reduce unit supply costs. Anticipation stock is often used to maximize the use of constrained capacity that serves event-based demand peaks.

### Big Picture Approaches Are Useful but Not Fully Actionable

Attempting to reduce cost by adjusting budgets or metrics is similar to declaring a target final score in a golf tournament. The goal will not result in success until it is broken into actionable initiatives. Practice time is allocated to the phases of the game — from driving and fairway approach shots to chipping, putting and hazard recovery shots.

*Gartner defines cost optimization as a business-focused continuous discipline to drive spending and cost reduction while maximizing business value. The distinction between cost reduction and cost optimization is more than rebranding. Aspirations to improve efficiency are constrained by the primary responsibility of supply chain to deliver high-quality products and timely service to customers.*

Figure 2 provides the visual overview of a previously published Gartner framework for supply chain optimization. Supply chain leaders have five levers to manage in pursuit of end-to-end cost optimization (see “Use Gartner's Supply Chain Cost Framework to Analyze Categories and Manage Levers”).
This framework represents a more complete and effective approach to performance improvement, compared to fragmented control of individual sites, functions and cost centers. It also promotes a systemic understanding about the specific supply chain levers that impact cost and must be synchronized to optimize overall performance. The main principles illustrated in Figure 2 include:

- Starting at the bottom of the inverted pyramid, tactical approaches, like supplier price negotiations (“deals”) and more efficient operating plans (“tactics”), are relevant but hold limited impact. They are actionable and have the potential to yield results within a short time period, and should be pursued continuously. Annual impact ranges from 2% to 5% of revenue, and may suffer from decreasing marginal return on effort over time.

- A significant portion of supply chain cost is structural in nature — as illustrated toward the top of the pyramid — which cannot be impacted by operating decisions. When competition drives increased complexity into product and service portfolios, supply networks must be aligned to enable reliable, efficient fulfillment of demand. This requires revisiting previous design choices to ensure networks have the necessary capacity, speed and flexibility to support business go-to-market strategies.
To enable timely decisions and scalable execution, changes in product supply and service delivery networks require upgraded planning and operating capabilities. Investing in process capabilities (enabled by talent and technology) is required to maximize value from the product portfolio and supporting network. Tactical strategies will not realize their full value potential if not enabled by sufficiently robust decision, transactional and operating process capabilities.

While holistic frameworks, such as shown in Figure 2, provide useful insights to address system complexity, they are difficult to operationalize within organizations composed of traditional operating functions. Modeling for decision support is complex, and it is not realistic to align all stakeholders around every design choice and operating decision.

Focus on Efficient Operating Outcomes to Sharpen Focus and Align Stakeholders

Top performing golfers remain focused on the present moment, planning and executing each shot based on the ball’s location and that hole’s hazards. Figure 3 illustrates a cost optimization “sweet spot” for supply chain organizations. Focusing on discrete operating outcomes breaks down cost optimization problems into measurable, repeatable events and conditions.

Figure 3. Align Stakeholders on Efficient Operating Outcomes

Align Stakeholders on Efficient Operating Outcomes

This allows organizations that operate complex supply networks to avoid the conflicts caused by cost reduction targets for individual functions. Multiple groups can align around design choices and operating decisions that minimize waste, while ensuring target performance for outcomes supporting business value.

Cost reduction efforts are constrained by the need to both protect and maximize business value (see “Supply Chain Brief: Advanced Supply Chains Add Business Value to Cost Focus”). This value is manifested within the company’s products and proprietary technology, its commercial relationships, brand image and organization capabilities. Supply chain leaders must find a method...
to define and communicate how the operating outcomes they deliver translate directly to supporting maximization of business value.

Figure 4 provides a schematic illustration for this essential alignment between business value and supply chain operating outcomes. In this case, three strategic imperatives are defined and supported by three discrete operating outcomes: efficient demand fulfillment, cost-optimized supply for established products and risk-optimized capture of new business (or launch of new products).

Figure 4. Optimize Operating Outcomes to Support Strategic Value Imperatives

Depending on the industry and business strategy, the nature and relative weighting of strategic imperatives will vary. However, the framework of Figure 4 provides an opportunity to ensure strategic alignment and minimize conflict in the pursuit of cost optimization. Profitable growth with sufficient investment return will almost always be a strategic imperative for commercial enterprises. Government and nonprofit organizations will have slightly different financial imperatives — perhaps expressed within the constraints of available funding.

Articulating strategic imperatives has an influence on how discrete operating outcomes are defined, enabled and prioritized. In Figure 4’s example, the product-centric supply chain’s performance is decoupled into three measurable outcomes:
Cost-optimized product supply (whether purchased from suppliers, produced internally or outsourced to external manufacturers)

Efficient service delivery, accompanying the fulfillment of product demand

Acquisition of new business via events that include business acquisition and integration, expansion of the supply and distribution network, new contract agreements, and new product launch

This engagement approach has the potential to change the nature of supply chain discussions with business stakeholders. It reduces conflict by reaffirming a commitment to support the business. Debates and negotiations about spending cuts and budget allocations can be replaced with aligning and clarifying specific network performance required to support the business. This process can potentially catalyze new thinking that identifies breakthrough improvement opportunities by defining target outcomes in a way that unleashes collaboration and innovation.

The potential of strategically-aligned outcomes is illustrated in two Gartner case study examples, summarized below:

**Tech Supplier Cisco Optimizes Product Supply Cost and Quality**

Cisco, a leading high tech supplier, described its approach to product quality as “fear based,” over-testing across every step of its value chain. This resulted in increasing costs for testing equipment and high levels of rejected supplier parts — particularly in the early stages of a new product launch.

The company organized an initiative to collaborate with its suppliers, with investment in advanced analytics for adopting quality testing protocols informed by process analysis. This enabled a reduction in testing equipment costs and lower rejected supplier parts rate. Quality testing protocols were managed and adapted during a product’s life, based on process and product data analysis. Product quality continued meeting performance requirements, while supply cycle times were reduced to improve responsiveness (see “High-Tech Manufacturing Supply Chain Innovators 2016: Connecting, Collaborating and Capitalizing on Complexity”).

**A Leading Supplier of Industrial Coatings Improves Delivery Service and Efficiency**

A leading supplier of industrial coatings evaluated its supply capabilities in support of an aggressive growth strategy. It discovered gaps in its demand fulfillment capabilities and performance, based on results from benchmarking and maturity analysis. A combination of legacy mindsets and incentives oriented around meeting functional cost goals emerged at the root of this gap.

Leadership for this supply chain took timely and comprehensive action: changes included incentive realignment across the organization to emphasize service performance. Supply lead times saw over 30% reduction by working with suppliers, as well as increasing their planning agility. Process improvements within warehouses increased the speed and accuracy of order fulfillment. These changes saw results that were immediate and dramatic. In addition to raising their on-time, in-full delivery metric by 15%, they also experienced a 5% efficiency benefit in reduced freight costs. These results demonstrate the potential for avoiding traditional cost-service trade-offs by taking a
Respond to Short-Term Pressure by Clarifying Outcomes

The examples above illustrate the breakthrough potential of systemic approaches that exceed what is possible with top-down control and reduction targets. During periods of short-term financial pressure, supply chain leaders must advocate for cost optimization strategies to be sharpened, not abandoned in favor of traditional practices. Rather than abdicating the responsibility to deliver efficient, sustainable outcomes, supply chain leaders should clarify specific performance targets with their stakeholders.

- Do customers still demand (and do product and marketing leaders still commit to delivering) the same levels of product quality as before? Is the business prepared to make trade-offs of quality to reduce cost?
- Are sales and service leaders committed to the same customer service levels? Are they prepared to institute new service rules (for some customer segments) related to minimum order quantity, order placement methods and lead times, cancellations and returns?
- Are manufacturing and finance leaders prepared to strike a different balance between working capital and manufacturing asset performance? Would higher inventory levels be acceptable to increase asset efficiency or reduce freight cost?

A focus on outcomes provides a mechanism to maintain organizational focus in an environment of pressure and uncertainty. Service and delivery organization leaders can maintain morale of their people by emphasizing outcomes, reinforcing the importance of redoubling efforts to protect precious company revenue and margin. Sourcing and operating organizations can also use outcomes, here to reinforce the importance of quality and reliability, while expanding their thinking to collaborate and innovate in search of changes that improve cost without putting outcomes and strategic imperatives at risk.

Growth Strategies and Events Complicate Cost Optimization

Business models are increasingly impacted by discrete events which must be managed as operating outcomes that impact cost and value. Examples include successful projects for industrial construction businesses, promotions for consumer products and seasonal demand peaks in agriculture and many other sectors. Future Gartner research will define and elaborate on the operating outcomes most applicable within specific industry sectors.

Figure 4 acknowledges the growth of advanced operating models that consolidate product, service and content into integrated solutions. Mastery of the operating outcomes defined here can serve as an intermediate milestone toward these more complex operating models that offer “outcomes as a service” to their customers. This topic will be addressed in Gartner’s research on supply chain strategies for supporting digital business transformation.
Focus on Operating Outcomes, Not Reduction Targets, to Optimize Supply Chain Cost

Published: 24 May 2019   ID: G00382831

Analyst(s): Paul Lord

Supply chain and business roles must align and collaborate around operating outcomes, rather than reduction targets, to optimize total cost. Supply chain leaders can use this research to adjust how they engage stakeholders and propose initiatives that achieve breakthrough cost improvements.

Key Findings

- Reduction targets for cost and inventory create apprehension and resistance among stakeholders, inhibiting the collaboration and innovation required to drive and sustain improvement.
- Attempts to reduce cost within individual sites and functions put quality and service at risk, or create constraints that limit improvement potential.
- Companies often pursue too many initiatives simultaneously without investing in the talent and technology required to enable improved performance.
- Supply chain organizations focusing on improving strategically aligned outcomes have demonstrated that trade-offs among cost, service and quality are not always necessary.

Recommendations

Supply chain leaders pursuing cost optimization should:

- Drive collaboration and innovation for improved performance by aligning multiple functions around cost-optimized operating outcomes.
- Enable decisions by defining metrics and developing cost analysis models that align to the scope and performance objectives of specific operating outcomes.
- Justify investments by proposing initiatives based on their potential to impact performance and deliver improvement to specific operating outcomes.
Winning in the Turns: A Supply Chain Action Guide
Become a Client

Get access to this level of insight all year long — plus contextualized support for your strategic priorities — by becoming a client.

gartner.com/en/become-a-client
U.S.: 1 800 213 4848
International: +44 (0) 3331 306 809

About Gartner

Gartner, Inc. (NYSE: IT) is the world’s leading research and advisory company and a member of the S&P 500. We equip business leaders with indispensable insights, advice and tools to achieve their mission-critical priorities today and build the successful organizations of tomorrow.

Our unmatched combination of expert-led, practitioner-sourced and data-driven research steers clients toward the right decisions on the issues that matter most. We are a trusted advisor and an objective resource for more than 15,000 enterprises in more than 100 countries — across all major functions, in every industry and enterprise size.

To learn more about how we help decision makers fuel the future of business, visit gartner.com.