Future of Work Enabler: Flexible Value Chains

Enabling the flexibility to choose and source value chain elements from anywhere – and change strategy as the market demands – is a key component of the future of work.
Executive Summary

It sounds so simple: Successful companies are effective at providing goods and services that their customers need, when and where they want them. The collection of activities that makes this possible — from the sourcing of raw materials to post-delivery service — are what we have historically called the “value chain.”

However, for a variety of reasons, the “chain” as we know it is increasingly becoming unlinked, sub-segmented and re-looped, as chain segments are flexibly inserted or removed, previously distinct links are melded into joined units, and links that were previously at opposite ends of the chain meet for the first time. The value chain, in other words, has become more of a continuously morphing value web.

Put less abstractly, value chain roles and activities that companies previously completed internally are now performed by external providers that provide a competitive advantage in speed, quality and cost. The reverse is also true; case in point...
are retailers that may soon become pseudo-manufacturers with the help of 3-D printing.

Meanwhile, processes that traditionally took place on-site — such as order management, medical management, clinical trial management and digital asset management — are moving to the cloud. With better access to real-time data and more fluid means of collaborating, upstream and downstream partners are working more closely than ever before. At the same time, value chain participants such as distributors are taking on new roles, such as assembling custom goods according to consumer needs and desires. Whole new ecosystems are being established as erstwhile competitors, teaming as partners, apply systems of engagement to virtually supply data-intensive services such as logistics management to fend off upstarts and embellish the value chain.

Perhaps most dramatically, the one-time last links of the chain — customers — are starting to take a leading role in the flow of events as their digital footsteps (what we call Code Halos™) resound ever more loudly on social media. (For more on this topic, see our white paper, “Code Rules: A Playbook for Managing at the Crossroads.”) In addition to the customer insights distilled from transactional systems of record, the unstructured data generated by customers’ clicks, tweets, likes and posts is increasingly being absorbed and analyzed by forward-thinking enterprises to formulate inventory strategies and inform the development of personalized, localized products and services. An example is auto dealers and manufacturers, which are increasingly investigating how they can use Code Halos to monitor and pre-seed potential sales and improve consumer loyalty through better ownership lifecycle management.

With globalization, heightened competition, faster morphing of consumer behaviors and the spread of social, mobile, analytics and cloud technologies (the SMAC Stack™) to measure demand signals, companies can no longer operate by adhering to a rigid and linear chain of events; nor can they afford to overlook the potential of these technologies to unlock new levels of productivity and collaboration by breaking down obstacles to flexible value chains.
The ability to perform value chain activities from the optimal source – and the agility to quickly shift strategies and sources when the situation demands – are separating the leading companies from the rest of the pack. Case in point, when the 2008 tsunami disrupted the Japanese supply of car manufacturers’ parts, U.S. and European automakers boosted production to flood the market and give consumers immediate choices as an alternative to waiting. The ability to take advantage of unforeseen disruption is now being incorporated into automotive manufacturers’ strategies.

Adopting a flexible value chain involves a range of considerations, such as alignment with business goals, a rethink of core vs. context competencies, and technology and cultural readiness. However, there are many benefits to adopting a flexible commercial model, as it supports how businesses need to operate today – and in the immediate future.

Flexible value chains are one of the eight enablers companies need to consider when mapping their journey of reinvention for the new world of work, as described in our overview paper, “Making the Shift to the Next-Generation Enterprise.” In this installment, we will look at the many choices and considerations businesses must make when remaking their value chain.

Mapping the Enablers to the 3 R’s

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Why A Flexible Value Chain is Essential

The value chain is a widely accepted model that describes a series of activities connecting the supply side (sourcing, inbound logistics, manufacturing) with the demand side (distribution, fulfillment, sales and marketing, customer service and aftersales service). But today, value chains are increasingly globalized and virtualized, as companies break apart key business functions into a series of work elements and strategically transform them into virtual capabilities that can be distributed geographically on-premise or delivered via the cloud.

Such value chain disaggregation opens new opportunities to leverage partners around the world to lower costs, access new markets and more quickly respond to changing market dynamics and more complex product and service requirements. Seizing these opportunities means thinking creatively about who should perform which elements of the value chain — as well as how and where those activities should be performed — and enabling those elements to be quickly relocated as market forces demand.

An example of the growing need for value chain agility is the trend among manufacturers to shift their global sourcing strategies from a “low-cost country sourcing” perspective to one based on “best-cost country sourcing.” While many companies moved their manufacturing operations offshore to lower their labor costs, the revised thinking in some cases is to move supply closer to areas of high demand to meet localized needs. Numerous factors are now being considered when it comes to determining where value chain activities are performed, including commodity price volatility, currency risks, quality adherence, rising labor costs, increased transportation prices, lead times and delivery cost, as well as product durability and performance.

Lenovo, for instance, built a new manufacturing facility in North Carolina in 2013 to improve the efficiency and reliability of product delivery in the North American market, in addition to providing custom product configurations. Another example is General Electric, which relocated some of its appliance manufacturing from China to Kentucky to be closer to centers of demand. These strategic decisions point less to a generalized retrenching on domestic soil and more a desire to flexibly change what gets done, and where, as marketplace conditions and customer demands evolve. (For more on this topic, see our white paper, “The Future of U.S. Manufacturing: A Change Manifesto.”)

On the other end of the value chain, retailers are trying out new inventory placement techniques, such as fulfilling orders from distribution centers or directly from manufacturers, in order to create the appearance of “ubiquitous” inventory (for more on this topic, see our white paper, “Manufacturers, Retailers Look to Adaptive Supply Chains to Increase Revenue, Cap Costs, Boost Productivity”). This is in response to consumers’ always-on capabilities, which is increasing their expectations for immediate response and empowering them to call the shots when it comes to levels of service.

Steps Toward Flexibility

Since no two companies approach the marketplace in the same way, there are as many ways to design the value chain as there are companies in the marketplace. Some businesses are already highly virtual, with the employee base mainly geared around sales/marketing and R&D functions, while others have traditionally performed most value chain activities in-house. For this reason, some companies already have a headstart toward breaking apart their value chain elements.
But no matter where the starting point is, moving to a flexible value chain involves several choices and considerations, including the following:

- **Aligning with business goals.** The first question to ask when devising a more flexible value chain is what the enterprise’s pain points are. Depending on the business goals and priorities, organizations need to target different sections of the value chain for disaggregation.

When upstream and downstream supply chain partners share data on the movement of goods – as well as unstructured data from social media on consumer preference patterns – the data can be leveraged to model demand and regulate supply, resulting in supply chain efficiencies both within the four walls and across the extended value chain.

Here are three common business goals and an example of which value chain segment should be targeted in order to achieve them:

- **Improving time to market:** Forget next-day delivery – thanks to Amazon, the new competitive edge is same-day delivery. In an Amazon-dominated world, fast delivery of end products has become an essential for many types of companies. As a result, if time-to-market is a big competitive factor, companies should consider positioning distribution, manufacturing and even logistics hubs closer to customer demand.

  In other cases, companies are breaking apart their one-size-fits-all supply chains and creating customized ones for regional markets. The increased diversity in the supply chain increases their ability to move products among supply chains as market conditions dictate, enabling them to reduce inventory costs while providing faster and more personalized service to customers.

- **Reducing costs:** The three major cost factors used by most companies to measure the effectiveness of their capital deployment are cost of goods sold (COGS), transportation (freight costs) and inventory carrying costs (measure by turns). Little wonder, then, that many companies approach cost-cutting by finding ways to lower their inventory numbers. To do that, forward-thinking companies are working to improve their collaboration capabilities with manufacturing, distribution and sales partners to gain more visibility into end-to-end inventory levels and become more flexible about moving goods into the areas of highest demand. When upstream and downstream supply chain partners share data on the movement of goods – as well as unstructured data from social media on consumer preference patterns – the data can be leveraged to model demand and regulate supply, resulting in supply chain efficiencies both within the four walls and across the extended value chain.

- **Innovating to produce new products and services:** Innovation is a high priority for nearly every C-level executive. In a recent global survey of 311 executives, conducted by Forbes Insights and Cognizant Business Consulting, almost three-quarters of respondents said they are under more pressure to innovate. (See the full report, “Innovation Beyond the Four Walls.”) Increasingly, companies are working to reverse the flow of ideas for new products and services, from company-to-customer, to customer-to-company. This is increas-
ingly possible through social networks, online forums, collaboration platforms and other mechanisms for gathering opinions, assessing sentiment and exchanging ideas. Starbucks, Pepsi, Procter & Gamble and others have led the way in welcoming customers into the value chain.4

Even data from online forums and communities can be used to drive assortment and inventory planning in retail. For example, an online community of health-conscious people might discuss their experiences with the latest model of a popular sneaker. The retailer and manufacturer can mine that data for ideas on everything from inventory placement, to customer support, to research and development.

• **Differentiating core from context.** Companies increasingly realize they cannot “do it all” and, moreover, that they don’t need to do it all. The competitors that are truly worrisome tend to be startups that seemingly appear out of nowhere with an innovative product or service that captures the meme of the moment by leveraging the digital footprints (or Code Halos) of customers, processes, employees and other enterprises. Learning how to collect and analyze the data from Code Halos — not to mention pouring it back into product development and business strategy to arrive at a new way of doing business — is where companies need to apply more of their resources. And they cannot do that when they’re also trying to do everything else, from soup to nuts.

This is another reason why businesses are increasingly urged to assess the building blocks of the enterprise and determine which functions are truly differentiating and offload the rest to trusted partners (see sidebar, next page). The relevant building blocks have expanded beyond call centers and IT services, to include elements of product development, marketing, sales, distribution/fulfillment, customer service, human resources, finance, legal and IT. Businesses need to break down those functions into sub-functions and assess what makes them “special.” Further, they need to determine whether any of these sub-functions can be customized for the enterprise or deployed in an interchangeable manner.

Organizations can create a 2 x 2 matrix with four quadrants to categorize and visualize their many functions and sub-functions and determine which action to take (see Figure 2).
Quick Take

Assessing Levels of Differentiation, Specificity

Determining which business functions are differentiating vs. non-differentiating is not a matter of sorting out core capabilities or “what we are good at.” Non-differentiating functions are the activities and tasks that must be performed well and might impact the P&L, but superior execution of these activities will not impact shareholder value.

Organizations can use the following supporting questions to identify whether a business function is differentiating:

- **Do the activities and tasks performed by this function make a direct contribution to increasing long-term shareholder value?**
- **Does this function create a competitive advantage?**
- **Does the function enable the company to grow faster than the market or maintain a high operating profit?**
- **For which already established and new capabilities is the company known in the industry?**

The following questions can identify whether a function is specific, or non-interchangeable:

- **Should the activities and tasks in this function be performed generically, or does the legal/statutory environment require unique activities and tasks?**
- **Which capabilities are unique to the company and support its key differentiators?**
- **Which capabilities require customization and integration with other parts of the business?**
- **Which capabilities could be identified as candidates worth sourcing or “partnering?”**

A good example for applying these questions is one of the most commonly discussed functions in a company: order management. Order management encompasses the entire client order process, including taking, managing and executing the order through all channels (Web, phone, mobile, in-store, etc.) and assigning orders to appropriate modes of fulfillment.

Based on our experience, companies often believe their order management process is a true differentiator – but let’s take a closer look. Can order management impact long-term shareholder value? Many respondents may say, “Yes,” but when they widen the picture and compare the impact of superior order management execution with, for example, pricing management, BI/analytics or customer solutions/servicing, they often change their mind. In the overall context, order management is indeed a very important supporting function, but it almost never acts as a “leading” function. In fact, many companies have started focusing on commoditizing order management functions since no incremental value can be achieved by superior execution. The trend to move contact center operations to a services provider is a clear indicator of the supporting value of order management.
Demassifying the Medical Device Value Chain

We recently worked with a global medical device company to support the divestiture of a complete line of business. In general, a medical device company is very similar to a traditional manufacturing company, as both have a strong focus on reverse logistics, device servicing and regulatory compliance. This makes for a complex value chain.

We used the value chain approach described in this paper to set up the divested company in the leanest possible way. We identified all business functions that were part of the new company and then led a facilitated series of exercises with the company’s executives to determine the level of differentiation and specificity of each function. Figure 3 illustrates the results of this analysis.

So what does this analysis mean? A direct interpretation would be that all functions in Quadrant 4 (colored yellow) could be handled by a low-cost service provider. There may be discussions around the applicability of this concept when it comes to patents and medical affairs management, but nobody will argue with functions like fulfillment execution, returns handling, billing/collections and payroll/benefits being supplied by a qualified third-party.

Assigning Business Functions to Quadrants

Figure 3
• **Establishing technology and cultural readiness.** Smart companies will rewire their IT infrastructure and strategically apply SMAC Stack technologies in order to add flexibility to their value chain. One area of high importance is breaking down the walls that exist between internal systems (particularly ERP, sales, inventory and operations planning) and also enabling better data sharing between these systems and those run by value chain partners. Doing so can result in a more transparent and “platform” view of value chain activities, enabling better decision-making and improving time to market – the single biggest barrier to creating a nimble company and competitive advantage. For instance, linking retailers’ POS data with back-end planning and order management provides insights into what is actually happening in real-time vs. relying on forecasts.

Organizations also need to create a way for unstructured data from the Web and other digital channels (mobile and social media) to be integrated with structured data from systems of record. Such data can provide insights on consumer trends, brand sentiment and even service or quality problems. By applying analytics to the combined data, insights and predictions can be sent to various value chain stakeholders, whether in product development, customer service, quality assurance or inventory replenishment.

An example is a tile manufacturer we worked with that historically had sold through dealers. As part of its effort to create direct relationships with customers, it began tracking customer behavior on its Web site. By analyzing this data, the manufacturer could identify the most popular SKUs and funnel this information back into its inventory planning systems to ensure the most in-demand products will always be in stock. The manufacturer expects an increase in revenue of 20% when this pilot project goes into full implementation.

Such technology change naturally leads to culture change within the organization for both business and technology leadership. For example, not only are internal constituents sometimes reluctant to make information available earlier than what they are comfortable with, but external partners can also be wary of the sudden transparency involved with data sharing. Operational level agreements and service level agreements are suddenly a critical part of creating collaborative success, which – if done correctly – can become a competitive advantage for both parties.

**Looking Forward**

In an age of uncertainty and constant change – particularly the changes wrought by unrelenting digitization – companies can no longer function via a linear set of interlocked processes. The business leaders of tomorrow will be agile performers that can quickly shift value chain strategies to optimize speed, quality and cost, while taking advantage of fast-moving market opportunities throughout the world. Such flexibility is possible when companies look at their value chains differently, with an eye toward disaggregating the function being performed from who is doing the work and from where the work is being done.

Most companies now realize it’s foolhardy to try and “do it all,” particularly with the development of an innovation economy that requires them to build entirely new competencies around understanding and applying customer, enterprise and process Code Halos. By establishing a more flexible value chain that allows them to continuously shift work effectively within an ecosystem of partners, businesses can refocus their efforts on what really matters for competitive differentiation.

What is more, agile sourcing of value chain elements will allow companies to quickly adapt to the conditions they face in the business world today, as well as tomorrow.
Footnotes


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