MAKE THE MOST OF YOUR CASH

Using global supply chain finance to manage uncertainty, complexity, and risk

By Gregory L. Schlegel, CPIM, and Peter Merke, CFPIM, CIRM, CSCP

Here we are, almost at the end of calendar year 2011, and the "new normal" of uncertainty, complexity, and risk is wreaking havoc with our global supply chains. The virtual shrinking of the world and a leveled playing field have made it possible for businesses to collaborate and compete globally more than ever before. Intellectual work, intellectual capital, and working capital all can be executed and delivered from anywhere in the world.

What does this mean for today's operations and supply chain management professional? For a new and different viewpoint on how to understand, assess, and respond to the current global marketplace, consider looking at it from the financial perspective. Banking, financial institution, and insurance organization professionals are fully aware of the fact that supply chain management is becoming a critical success factor, and they offer a unique vision for how to survive and thrive.

Finance people see supply chain management as the end-to-end activities of all the participants involved in transactions pertaining to the movement of goods and services. Financial experts deem the goal of supply chain management to be the pulling together of three distinct information flows—commercial, logistical, and financial—with the objective of minimizing risk, optimizing working capital, and boosting the bottom line.

Three critical flows

Understanding these information flows leads us into the world of global supply chain finance. In its simplest form, global supply chain finance is the holistic approach to improving a company's cash-to-cash cycle time, also called the cash conversion cycle. (See Figure 1.) The *APICS Dictionary* defines cash conversion cycle as "the length of time from the purchase of raw materials to the collection of accounts receivable from customers for the sale of products or services." The result is found by adding the number of days of inventory to the number of days of outstanding receivables and then subtracting the number of days of outstanding payables.

As you look at Figure 1, keep in mind that the goal is to perfect the overall financial performance. Of course, optimizing financial functions often requires trade-offs between metrics; for example, growth versus profitability, customer service versus expense, and service levels versus inventory. Focusing on just one or two metrics typically results in suboptimal overall performance.

In addition, operations and supply chain managers now must take the traditional financial driver of the cash conversion cycle a step further. With increased uncertainty, complexity, and related hazards, their focus must broaden to include managing two additional critical flows: risk management and risk mitigation.

For example, innovative organizations are beginning to inject risk and the enterprise risk management (ERM) framework into their sales and operations planning (S&OP) process. According to international professional association Institute of Internal Auditors, ERM is "a structured and coordinated entity-wide governance approach to identify, quantify, respond to, and monitor the consequences of potential events. (See sidebar.)

An ever-growing number of company decision makers also are choosing to develop risk management programs and hire chief risk officers. And some progressive businesses are evaluating the risk in their supply chains using web-based assessment tools, such as heat maps. (See Figure 2.)

Heat maps are structured assessment tools that enable users to evaluate each dimension of the supply chain network. They combine a set of best practices and are tailored to industry specifics.

The typical deployment of a heat map assessment includes three basic steps. First, all elements of the organization—depicted here as leadership, customer demand, logistics, integrated supply chain, supply, manufacturing, information systems, industry, S&OP processes, and balanced scorecard—are evaluated. This measurement is accomplished with a risk maturity assessment tool, which enables users to identify potential events that may affect a business, manage those events, and provide reasonable assurance regarding the achievement of business objectives.

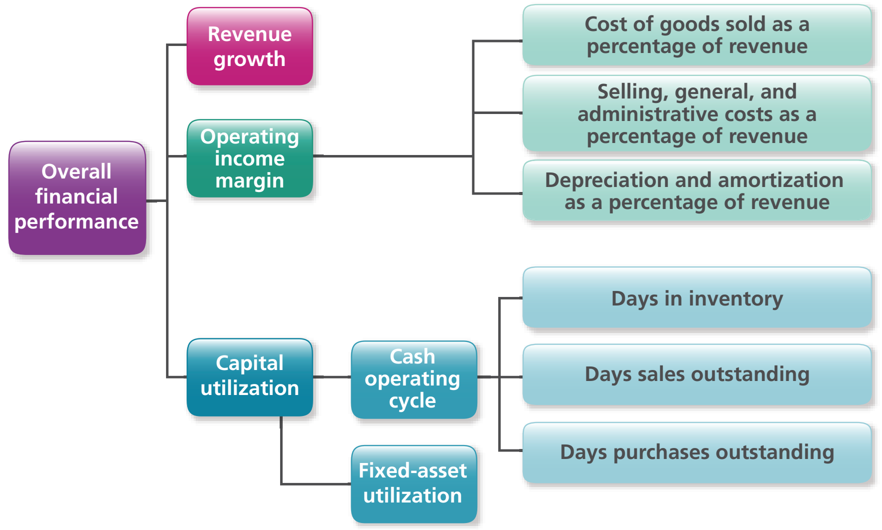

Figure 1: Key financial drivers

Such a framework makes it possible to evaluate risk maturity across different dimensions.

Next is the deployment phase, during which a comprehensive process checklist is developed. This checklist should cover all aspects of the organization's supply chain network. Each aspect then is rated based on best-in-class risk maturity models and industry risk elements.

Finally, a workshop leader is responsible for planning and delivering the results for each attendee and discussing the assessment score.

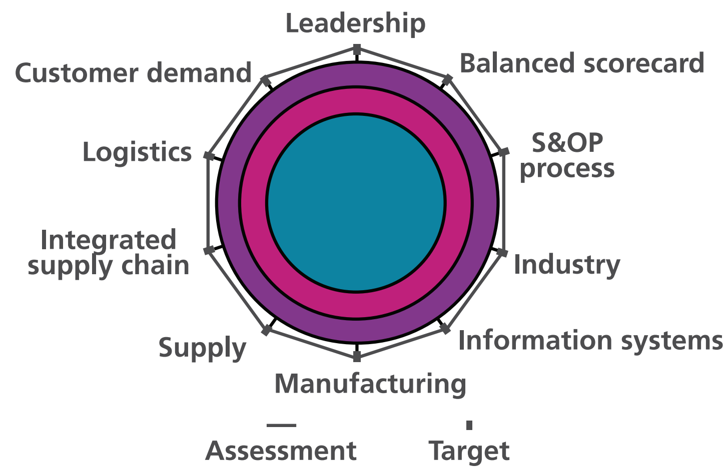

Figure 2: Supply chain risk management heat map assessment

Exploring ERM

According to international professional association Institute of Internal Auditors, key enterprise risk management (ERM) roles and assurance activities include:

- providing assurance on the design and effectiveness of risk management processes
- providing assurance that risks are correctly evaluated
- evaluating risk management processes
- evaluating the reporting on the status of key risks and controls
- reviewing the management of key risks, including the effectiveness of the controls and other responses to them.

Key ERM roles and activities recommended by the institute include:

- championing the establishment of ERM within the organization
- developing a risk management strategy for board approval
- facilitating the identification and evaluation of risks
- coaching managers on how to respond to risks
- developing and maintaining an appropriate ERM framework.

Relevance and trends

Why is global supply chain finance important? According to accounting firm Killen & Associates, a typical billion-dollar company spends approximately $27 million annually on unnecessary working capital and inefficient processing functions because the organization lacks visibility into the financial supply chain and receivables. In fact, the total value locked up in inefficiencies associated with the global supply chain is estimated to be from $500 billion to well over $1 trillion.

In addition, strategic advisors from The Hackett Group wrote in the 2005 Book of Numbers, "An additional turn of working capital can enable companies to boost net profits by up to 11 percent. On average, a one-day reduction in the sales cycle is worth approximately $80,000."

And AMR Research reported in 2006, "Supply network complexity is increasing … The average $1 billion company manages 15 internal manufacturing sites and 38 contract manufacturing providers across five supply chains in at least two continents."

Management consultancy PRTM offers the following insights into today's supply chain trends:

- Consumers are increasingly price sensitive and less brand loyal, resulting in commoditization and a permanent increase in supply chain volatility.
- While most participants are looking to international customers for future growth, few are prepared for the complexity that results from serving global customers.
- End-to-end supply chain cost optimization will be critical going forward.
- Risk and opportunity management should span the entire supply chain, including key partners.

Global supply chain finance excellence

In the face of uncertainty, complexity, and risk, there are key steps to be taken when aiming to optimize your company's global supply chain finance practices. First and foremost is assessment—as discussed previously—which is followed closely by awareness Recognizing the fundamental building blocks of this new financial perspective on supply chain excellence is essential.

Awareness encompasses the following elements:

- Understand the "as-is" current state. Ask questions such as: What is the business's cash conversion cycle time? Where do we stand relative to the best-in-class metrics? What can we do to affect the company's position?
- Embrace approaches such as supplier relationship management, which is a structured method for enhancing supplier visibility, velocity, and value.

Recognizing the fundamental building blocks of this new financial perspective on supply chain excellence is essential.

- From a manufacturing, inventory management, and supply chain optimization perspective, employ new probabilistic methods that enable users to exercise demand pattern recognition. This makes it easier to sense, shape, and profitably respond to demand.
- Develop scenario planning within the organization's S&OP process in order to run stress tests on the supply chain and what-if scenarios with probabilities of occurrences. With these tasks complete, more effective risk response plans can be developed to effectively mitigate those risks.

Businesspeople today want many things from their supply chains: higher-value-adding revenue growth, improved profitability, better capital utilization, and lower cost of capital, to name just a few. They also strive for improved supply chain visibility, which often means helping at-risk suppliers in order to ensure deliveries happen on time, using risk analysis tools to identify these suppliers as soon as possible, and actively providing financial support to strategic suppliers.

There is no doubt that global supply chain finance is a compelling approach to more effective supply chain management. Seeing the global network from the standpoint of financial professionals may be the next essential step to overall operational excellence.

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Editor's note: To learn more about the role of global supply chain finance in operational excellence, attend Global Supply Chain Finance: An Executive Workshop at the 2011 APICS International Conference & Expo in Pittsburgh, Pennsylvania, October 23–25. Authors Gregory L. Schlegel, CPIM, and Peter Merke, CFPIM, CIRM, CSCP, will present an interactive workshop that demonstrates cause-and-effect relationships, explores the supply chain finance metric of success, and illustrates several modeling techniques.

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