Segmenting for Success –
From Value Chain Theory to Everyday Execution

By Sean Culey

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"Real artists ship."

Scrawled on an easel in January 1983 by Steve Jobs, this message was directed at his Apple team who were months overdue on launching the first Macintosh computer. He wanted them to understand that their innovations were worthless unless successfully transformed into products that the customer could buy. Innovation needs execution. Decades later, that message is now more important than ever. Globalisation means that Supply Chains have become increasingly complex and carry increased levels of internal and external risk. Volatility and turbulence is the new norm, placing even more emphasis on a business's ability to deliver. The only certainty is that uncertainty will increase.

The recent spate of supply disruptions caused by natural, social and economic factors has proven that shareholder and market value is intrinsically linked to the business's ability to maintain supply at a level that the customer associates as being 'of value'. Companies now need to be both *highly disciplined* in execution, and have *agility* to respond to demand deviations and supply disruptions. The relentless 'growth at all costs' and 'always lowest cost' mindset has created organisations that may achieve short term results, but lack sufficient control of their end-to-end Supply Chains in order to successfully compete in the long term.

In my previous articles for *The European Business Review* I discussed how to create 'strong foundations' for growth based around the '7 Keys'; creating integrated alignment from the *goals and strategies* of an organisation throughout its *people, measures, processes, systems*, and *data*, and supported by its *culture*. I also discussed how segmenting the business into customer focused 'Value Chains' is a key element of achieving this alignment and integration.

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But theory is all very well; however theory has little value unless it can be successfully translated into everyday execution. As Michael Dell, CEO of Dell Computers once said; "*Ideas are a commodity, execution of them is not*."

Start with the Essentials

The concept of 'value' needs to be defined in order to understand the concept of 'Value Chains', for in many cases both are unclear.

Peter Drucker had the ability to distil complicated theory into understandable practice. He stated that there are 'five essential questions' you must ask about your organisation:

- What is our mission?
- Who is our customer?
- What does the customer value?
- What are our results?
- What is our plan?

My last article examined establishing

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a clearly defined purpose, mission and set of values that constituted the DNA of an organisation. I will now discuss how to segment the business into 'Value Chains' designed to deliver customer value.

Drucker also stated in '*The Practice of Management*' that; "*it is the customer who determines what a business is.*"

But what is value to a customer?

Businesses that devote time to truly understanding "*how can I add most value to our customers*" rather than '*how do I maximise utilisation of my production capacities and hit my sales quotas*?' are taking the first steps to creating an end-to-end organisation geared to deliver products and services that the customer would choose over the competition. The Value Chain approach supports this as it moves focus away from designing a supply chain from raw materials through to the finished product, and instead takes a '**work from the customer back**' approach. It focuses on understanding what strategies, behaviours and structure you need to follow in order to provide your customer with what they value – and then evaluate what people, processes, measures and systems are required to deliver this.

Generators of Value, not Collectors of Costs

The concept of a 'Value Chain' was first introduced by Michael Porter in his 1985 best-seller, '*Competitive Advantage: Creating and Sustaining Superior Performance*'. It has now been extended beyond individual organisations and now applies to the end-to-end supply chain; from product design to reverse logistics.

It requires the identification of all components contributing to the production of goods or services that create customer value and then obtaining competitive advantage by being perceived the supplier 'of highest value'. Obtaining this status depends less on the individual performance of each of the functions, processes, systems, suppliers and buyers within a Value Chain and more on how well they integrate and function as an entire end-to-end chain. Synergy, getting more **value** from the **chain** than the sum of the parts, is required. The Value Chain should be focus on becoming effective in developing processes that deliver customer value, and efficient in their execution. As value is derived from customer needs, activities that do not directly or indirectly contribute to meeting them are eliminated.

Lack of supply chain control directly impacts profitability and shareholder value; any failure to meet customer requirements decreases the ability to negotiate higher prices or product positioning.

Two recent clients provide great examples of this. In the first, a steel company, the major issue was that despite having world class steel, they couldn't sell it at the premium price it warranted, due to the fact that the premium customers wouldn't buy from them. Why? Because they failed to consistently achieve acceptable service levels. The second client, in Aerospace & Defence aftermarket spares and repairs, was convinced that their customers were only interested in reducing cost. The reality was that even a 50% price drop wouldn't have made any difference to the customer – because it **wasn't the issue**. Value to the customer was not in cheap spares and repairs; it was in having **operational vehicles** and reliable information as to when that would be achieved. In both examples the Value Chains needed to focus on ensuring reliability at every stage of the end-to-end process - from provision of reliable information through to reliable product delivery.

Segmenting to Success

Whilst rarely implemented, the concept of segmenting the business into different supply chains engineered to match customer and product requirements is not new. In 1974, Wickham Skinner wrote an article for the Harvard Business Review called '*The Focused Factory*', where he identified the 'one size fits all' model as being non-optimal, creating a need to overcome conflicting priorities within the factory.

Skinner's Focused Factory concept rested on three underlying concepts:

- There are many ways to compete besides low cost
- A factory cannot perform well on every measure
- Simplicity and repetition bring competence

Most organisations generally have only one Supply Chain team, executing a single set of processes, people and performance metrics. However, they often have multiple product types varying from 'make/procure to stock', 'make/procure to order' or 'engineer to order'. Stocked products are further differentiated into fast and slow moving, innovative or functional, mature or new.

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Applying a 'cookie-cutter' model to different supply chains results in averaging; the good supply chains compensate for the bad, and the bad brings down the good. Measures like service levels, inventory, utilisation and cashflow are averaged across the business, and don't give a clear indication as to where the problems lie and what drives Customer Value.

But where do you start?

The Supply Chain Council (SCC) is a global, not-for-profit organisation responsible for the continued development of the Supply Chain Operations

Figure 1

Supply Chain Definition Matrix		Geography - Customer or Market channel							
		Retail Discount	Retail Premier	Cash & Carry	Regional Impulse	Europe	Africa	India	USA
Products	Low Cost, High Volume Product	X	X	X	X	X	X	X	X
	Premium Product		X	X	X				
	Premium Innovative Product		X	X	X	X	X	X	X
	Low Cost Innovative Product	X		X	X				

Reference (SCOR) model. SCOR contains a detailed process model and hundreds of metrics aligned to Porter's Value Chain model, as well as prescriptive best practices for process execution, and has been adopted by hundreds of companies. The SCC has also adopted a SCOR implementation methodology called '*Supply Chain Excellence*' (SCE), taken from Peter Bolstorff's book of the same name. One of the first steps in the SCE approach is the identification of the different Supply Chains that may exist.

Defining your supply chains involves establishing all combinations of products that are sold and customer groups you sell them to. Figure 1 shows the output of this exercise from one of our clients, a FMCG beverage manufacturer.

'X' denotes current product/customer combinations, whereas 'X' indicates future activity - either planned product introductions or new markets. This 'future Supply Chain' analysis starts to define how a business will achieve its aspirational growth targets.

Once all products and markets have been analysed; next is to group these together in terms of behavioural and logical characteristics, to form 'supply chains'. This Company's supply chains were based around the customer geography element, and were identified as:

- **Retail Discount (Domestic)**
- **Retail Premier (Domestic)**
- **Cash & Carry (Domestic)**
- **Regional Impulse (Domestic)**
- **Export (EMEA & Asia)**
- **Export (US)**

Playing to Win - Understanding Competitive Drivers

Once the supply chains have been identified, the business can establish how each supply chain competes from a customer value perspective.

No single supply strategy is applicable to all product types, so understanding what creates value in each supply chain is important and insightful. SCOR proves helpful by providing five Supply Chain Attributes to consider; Reliability, Responsiveness, Agility, Cost and Assets, as well as a 3-tier set of aligned metrics for each of these attributes.

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Issues arise when businesses try to focus on being good at everything, regardless of whether it is strategically important. The SCE method proposes defining where the supply chain needs to be competitively **Superior** (top 10%), **Advantage** (within top 25%) or simply **Parity** (average). Selecting a key strategy per Supply Chain prevents an organisation from focusing on multiple counter-productive measures at once, such as trying to be both low cost AND agile.

Figure 2 (below) shows the Competitive Drivers for the aforementioned Beverage company.

There are two distinct behavioural drivers running through their six Supply Chains. Whilst Reliability is a key driver in all, within 'Premium Retail' and 'Cash & Carry' it is essential, whereas in the 'Discount' and 'Export' Supply Chains, the low cost of the products is the most strategically important factor, as this is what creates the demand.

Understanding how a Supply Chain competes allows a business to appropriately use improvement methodologies and risk management techniques. If reliability is the key competitive driver but the supply chain has been designed purely from a low cost perspective to be lean and efficient, then it can be very intolerant of any supply disruptions, and the impact from a customer value perspective can be devastating. Focusing on 'Competitive Strategy' allows the organisation to selectively target which supply chains need more focus on risk mitigation.

Competitive Strategies and Product Lifecycle Management

Since Skinner's article was published we now know that a product's competitive strategy may change as it matures and moves through the different stages of its lifecycle; thus the strategies, structure, processes and team metrics and behaviours should also change to maintain competitiveness.

For example, a make-to-stock product may require high levels of reliability throughout its life, but during the

Figure 2

Competitive Driver		Supply Chain					
Focus	Performance Attribute	Retail Discount	Retail Premier	Cash & Carry	Regional Impulse	Export (Europe & Asia)	Export (US)
SERVE	Reliability	Advantage	Superior	Superior	Advantage	Advantage	Advantage
	Responsiveness	Advantage	Advantage	Advantage	Advantage	Advantage	Advantage
	Agility	Parity	Parity	Parity	Parity	Parity	Parity
COST to SERVE	Cost	Superior	Advantage	Advantage	Superior	Superior	Superior
	Assets	Parity	Parity	Parity	Parity	Parity	Parity

Successful Customer Value Chain implementation depends on the ability of the organisation to break down the 'walls' and fixed mindsets that divide functional teams; changing detrimental behaviours into common goals and joined-up agendas.

launch and introduction stages responsiveness and agility is required to be able to respond to uncertain demand. Once a product matures in the marketplace, demand patterns stabilise and focus moves to retaining service levels whilst competing on price; therefore strategically, a more cost focused, efficient strategy is required. Finally, as the product reaches the end of its life, the business may go back to a more responsive strategy and reduce production frequencies to handle the uncertain nature of its decline.

Figure 3 **Product Stage of Life and Competitive Strategies**

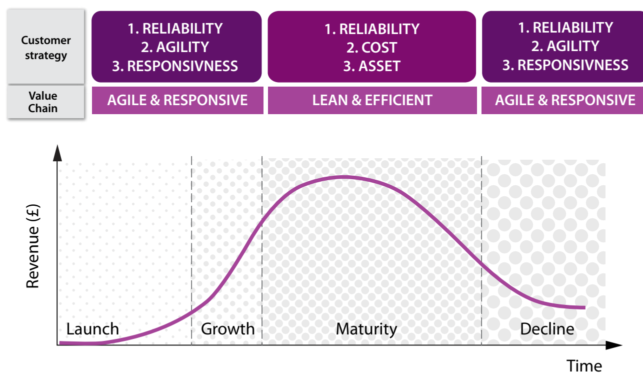

Figure 3 illustrates what this 'stage of life' Value Chain strategy might look like.

Products can be allocated to the correct Value Team and strategy, and set up with the correct MRP and Master Data settings. These may change as a product matures through its lifecycle, allowing the business to be in 'control' of the way products behave and how the supply chain is designed to support customer requirements.

Challenging the Status Quo – Changing behaviours

Designing new processes, roles and systems is always challenging – but the real issue is change; getting people to adapt to new ways of operating and defeating internal forces protecting the status quo. Successful Customer Value Chain implementation depends on the ability of the organisation to break down the 'walls' and fixed mindsets that divide functional teams; changing detrimental behaviours into common goals and joined-up agendas. Aligning functional performance metrics to the strategy can create rapid behavioural change.

What service-based customers generally value is *reliability* in supply. What they hate is **uncertainty**; they don't want the first time they know there is an issue to be when the order arrives late, short, or both - they would much rather hear that there is an issue as soon as possible whilst the option of choice is still available to them. They want to be able to plan – to be 'in control'. Unreliable suppliers make them look unreliable, causing them to 'buffer' for uncertainty – usually by ordering a higher quantity than they really need, or by making emergency orders when they realise stocks are low. The famous 'bull-whip' effect is caused by the end-to-end supply chain over-reacting to this demand deviation. Therefore, creating measures across the Supply Chain that support and provide reliability is important.

Ensuring Everyday Execution – from IBP to IBE

The challenge is to take the complicated theory behind the Value Chain concepts and turn it into a simple, repeatable, practice. An Claes, Head of Innovation at Nike, recently explained at a European conference how Nike have 'Operationalised Innovation', consistently and deliberately at all levels of the organisation through incremental changes in performance against strategic objectives. The key, says Claes, is to "*boil down a strategy to something that is relevant to the people at ground level. Strategy is easy – it's making it work that's the hard part.*"

This is one of the major benefits of the Value Chain approach; it creates an organisational structure that, whilst still focused on functional excellence, is designed to create cross process understanding of how to create value, and translates this understanding into both strategic and operational activities. *The Customer Value Chain* approach creates a change to strategic processes like S&OP and Integrated Business Planning (IBP) by changing focus from just talking about products and markets to focusing on the performance of each

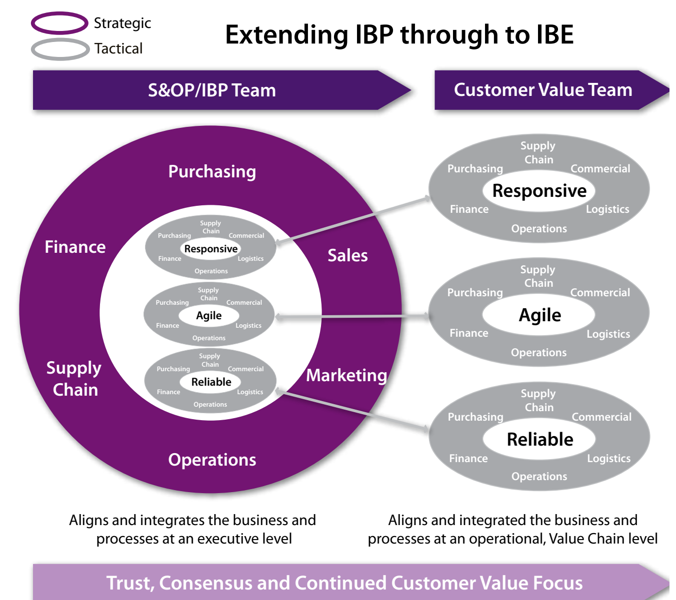

Figure 4

of the Value Chains. S&OP and IBP helps to break down functional barriers and develop trust throughout the executive team through open, transparent communication about corporate strategy, financial targets, marketing plans, demand forecasts and supply realities.

These principles need to be maintained into short-term operational execution; developing **Integrated Business Execution** (IBE) for each of the Value Chains in the organisation. This brings together the different functional areas to ensure that the consensus achieved within the executive team is retained and protected; embedding the concept of the business working together to a common 'drumbeat' in order to deliver customer value. Figure 4 (p.74) shows what this relationship can look like.

Marching to a regular drumbeat

Regular Weekly and Daily meetings are an essential element of the Customer Value Chain approach. In these '*Customer Value Team'* meetings, functional representatives meet to ensure that there is consensus at operational level as to the Value Chain strategy, targets, responsibilities, issues, root causes, and action plans.

Weekly meetings should follow the principles of effective execution, as developed by FranklinCovey:

- ***Focus on the most important strategic goals.*** The Value Chain strategy of focusing on one 'Superior' and two 'Advantage' competitive drivers helps create focus.
- ***Translate Strategic Goals in Individual Actions.*** Develop new ways of working that support and enable the delivery of the strategic drivers. In a Responsive Value Chain, the integrated team needs to identify how each individual role should be measured in order to ensure responsive supply to customers; the time taken to respond to RFQ's, to create master data, to process orders, to manufacture, to source materials etc.
- ***Create compelling and motivating scoreboards*** that are focused on the relevant strategic drivers and immediately show whether they are winning. Scoreboards should show change over time, be updated weekly and placed in highly visible locations.
- ***Create a consistent focus on disciplined accountability*** – each role in the Customer Value Chain must know how their own behaviours relate to the strategic drivers – developing clear line of sight between their processes, roles and responsibilities and the strategy. An empowered and accountable mentality is required, not a 'command and control' one.

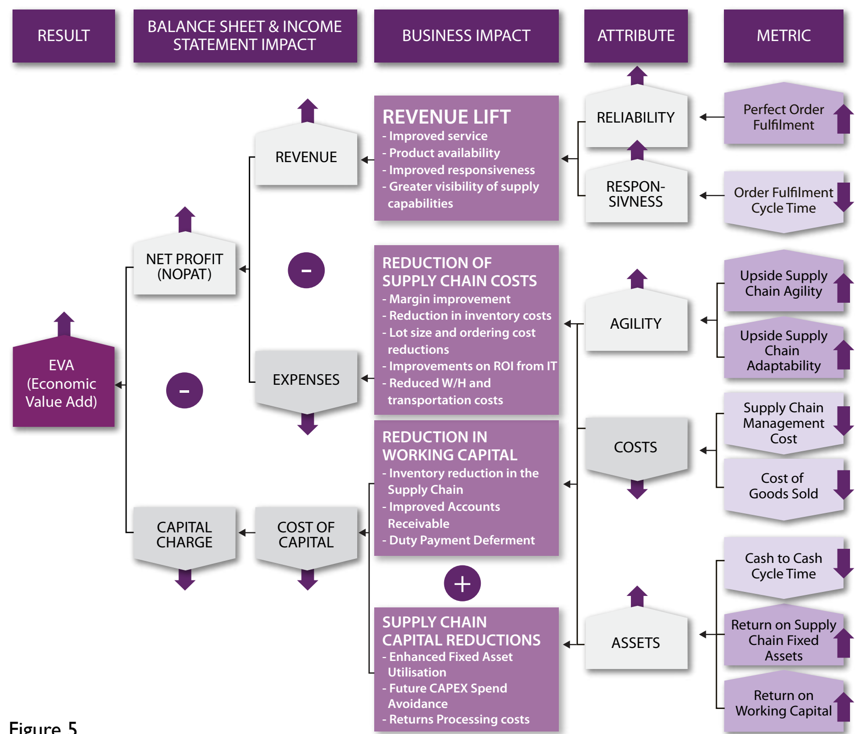

Figure 5

Each process area needs to define the Performance, Conformance and Data measures that support the competitive drivers, in order to answer these questions:

- Are we closing the gap between where we are and where we want to be?
- If not, where are the constraints? Where are the risks?
- How can we improve? Where are the opportunities?

Weekly meetings allow the team to zoom out to focus on customer value, then zoom in and drill down to the root cause of any issues preventing the business from creating this value. It brings together people from the different supply chain functions 52 times a year in order to focus on a common goal, building trust, removing barriers and creating responsibility and accountability for results. It creates urgency and a continuous improvement mentality.

Daily meetings acknowledge that issues will undoubtedly arise, despite best efforts. They need to be short, focused and scheduled at a time that allows the team the opportunity to analyse why issues exist and intervene before they became service failures and stock-outs. They are designed to ensure that reactions to short time issues are in line with the strategic goals.

Disciplined Focus on Continuous Value Improvement

The outcome of focusing on providing value to customers is in the generation of revenues in excess of costs – creating profit which in turn creates shareholder value. Each Value Chain should financially measure the Economic Value Add (EVA) it brings to the organisation. Figure 5 (above), based on the 'DuPont' model, shows how working on the key SCOR measures can improve the performance of each

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of the relevant attributes, and have a positive impact on financial results.

Measuring the EVA for each Value Chain creates association between operational activities and organisational performance; showing how the 'front line' drives 'the bottom line'. This is why I always recommend having financial representatives in the Value Team.

Clarity of this alignment between their activities and EVA empowers each Value Team with the ability to focus on increasing the **Effectiveness** of that which directly adds value, the **Efficiency** of supporting and enabling activities and the **Eliminating** of that which destroys value. These improvement activities can then be combined into a Value Chain 'Improvement Roadmap', with success measured by the incremental increases in the competitive drivers. The Value Chain Team(s) then focuses on developing continuity of strategy whilst also continually improving - this '20 mile march' approach creating far greater value over time than businesses that constantly change strategies and direction in order to achieve short term growth spurts.

Results

Given that non-financial organisations have from 60-90% of their costs tied up in their end-to-end supply chain, it is no surprise that those who focus on developing effective supply chains as a source of competitive advantage consistently record higher market value than those that do not.

The Supply Chain Council tracks the value of having a supply chain focus using their **'SCOR index'**. This monitors the financial performance of SCC members versus the Dow Jones Industrial Average and Standard and Poors 500 Index. SCC members consistently track at a higher value than the average, and were able to stay above the line even during the 2008 crash, reporting growth of 85.96% since 2003, compared to 44.47% for the Standard and Poors average.

Adopting this approach is not easy and requires breaking historical models and paradigms in order to think and act differently. It requires strong leadership, dedication and discipline. As E.M.Gray stated; "*successful people have the habit of doing the things failures don't like to do. They don't like doing them either…but their dislike is subordinated to the strength of their purpose.*"

When I first implemented this approach ten years ago it was revolutionary and challenged the business on every level. I called it '***Demand Control***', for although you cannot always control demand, you **can** always **control** your **responses** to demand. Although I would love to claim that segmentation was my strategic goal; the truth is that it wasn't – initially the objective was simply to progress from a reactive, fire-fighting, functionally divided business into an aligned, integrated, in-control one. The sub-division of products and markets into their own behavioural characteristics was based on supply constraints; not intelligent design. However, changing behaviours and networks to support these strategies worked as it created focus, team alignment and appreciated the behavioural differences between the supply chains. In one business unit where we implemented a *Reliable* Value Chain strategy and team, we achieved:

- Reduction in working capital from 10 to 2 weeks
- Increase in service levels from 85% to 99+%
- Reduction in product obsolescence from 30,000 – 40,000 tonnes of unsalable goods to zero
- Reduction of phone based customer service queries from 64,000 to 32,000 calls per year
- Clear end to end process with full visibility
- Resolved many potential service issues before they happened
- Replaced reactive panic with proactive calm
- Dramatic increase in customer satisfaction

A business that understands the different ways it competes and has clearly defined strategies based on customer value with aligned measures, roles and responsibilities is one where trust and certainty can replace mistrust and uncertainty, and proactive action replaces knee-jerk reaction.

Ralph Drayer, former Chief Logistics Officer at Procter & Gamble, probably put it best; "*At P&G, we decided to stop being so company-centric, and start being customer-centric and demand-driven. We found when you do that, some amazing things happen.*"

About the author

Sean Culey is a member of the European Leadership Team of the Supply Chain Council, the global, not-for-profit centre for SCOR and Supply Chain Excellence, and Principal at Solving Efeso, a top management consultancy firm with a leading reputation for connecting strategy with action. Prior to this he was CEO for SEVEN Collaborative Solutions.

Sean has worked around the globe helping companies create dramatic increases in profitability and market growth through the alignment and integration of their people, processes, systems and data into segmented Customer focused Value Chains and Value Chain Teams. Sean was designing, developing and implementing highly effective 'demand-driven, sense and respond' Value Chain processes, tools and ways of working, years before these terms became commonplace.

Sean is a frequent conference speaker and has had many articles published on Organisational Greatness, Culture and Value Chain excellence.

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