Operational Performance Excellence

How to cope with the global financial crisis

The financial crisis has consequences for all industry sectors. Companies need to react rapidly to offset the negative impacts of reduced market consumption and limited credit availability (credit crunch). One major approach that offers a high and sustainable improvement potential involves optimizing the value chain. Increasing the effectiveness and efficiency of its distinct areas and achieving overall synchronization of these areas can yield results that immediately improve the economic success of the company. Combining cross-industry benchmarking studies and comprehensive optimization tools, Arthur D. Little has developed a holistic solution package to release the full potential of the value chain.

Who is effected by the expanding financial crisis?

The US subprime crisis that was mainly restricted to the real estate business is currently showing ever increasing ramifications. Following the rapid downturn of the US stock exchange, Europe is gradually suffering the same fate. In September 2008 the Dow Jones plummeted to a three-year low. The ifo Business Climate Index has been falling continuously since January 2007. Furthermore, the Euribor rates have been at a 14-year high in October 2008. As a consequence European governments have nationalized banks at high risk and set up multi-billion-dollar rescue packages in order to regain stability.

The serious problems in the financial sector have already led some companies to implement comprehensive cost reduction programs while others – even renowned commercial banks – have gone bankrupt. On the horizon, similar consequences can be perceived for goods and service providers. The banks’ problems have led to increasing difficulty for borrowers (credit crunch), and this has a direct effect on the capital available to a company and on the willingness or ability of customers to invest and consume. The negative consequences are liquidity squeezes and a decrease in turnover through declining consumption. The prognosis in terms of economic growth for 2008 is still at 1% to 1.5%; however, current forecasts for 2009 indicate a potential recession. Thus experts worldwide are anticipating a downturn of the economic cycle to a greater extent than it was previously assumed.

Other risks, furthermore, are lurking, and they threaten the business of European producers. Companies from low-cost countries are still gaining ground and surging into local markets. They take advantage of low production costs resulting in low-priced offers European firms often cannot match.

These and other factors such as rising raw material and energy prices are intensifying the financial pressure on producing firms. The need for greater independence from external factors and institutions is rising just as the ability to react flexibly to ever-changing market situations is gaining renewed importance.

Reacting proactively to struggling markets

Companies are driven by consumer markets and, in most cases, can only influence these to a minor degree. However, they can prepare themselves to minimize the negative impact of market forces on their own business. An effective and efficient approach to freeing capital, downsizing costs and increasing their flexibility involves optimizing the value chain overall. An investment here can provide relief even if the firm has already been impacted by the situation. Despite budgetary stress initially, a lean and cost-efficient value chain can stabilize the business in the mid and long term.

Companies planning to act against the trend of cash-outs and declining turnovers need to take advantage of the following three levers:
1. **Sustain or even increase revenue** by improving customer value and satisfaction through:
   - customer relationship management (CRM)
   - sales programs (cross-selling, direct marketing concepts, etc.)
   - Value analysis and improvement

2. **Reduce costs** to offset the impact of anticipated revenue shortfalls by:
   - initially adjusting capacities to the reduced market requirements
   - insourcing value-added activities to utilize excess capacities
   - optimizing processes and the organisational setup to eliminate all forms of waste and reduce non value added activities

3. **Minimize capital requirements** to prepare for the anticipated liquidity bottleneck and the increasing costs of capital by:
   - harmonizing the overall value chain to reduce trade working capital (accounts receivable, accounts payable, and inventory)
   - reviewing current and planned capital expenditures to downsize or postpone planned projects in light of the reduced market requirements

**Enhancing the value chain: Operational Performance Excellence (OPE)**

Building on its extensive project experience and deep functional knowledge in all major industries, Arthur D. Little has developed the Operational Performance Excellence (OPE) Framework. (Figure 1).

This solution package concentrates on lean principles leading to an overall value chain improvement. It includes high level, strategic modules such as strategy validation and development, operations network redesign and product portfolio optimization. In addition, the OPE Framework focuses on three main functional excellence areas:

- Purchasing (**PPE** – Purchasing Performance Excellence)
- Supply Chain Management (**SPE** – Supply-Chain Performance Excellence)
- Manufacturing of goods and services (**MPE** – Manufacturing Performance Excellence)

The strategic modules and optimization initiatives in the functional excellence areas are complemented by cross-functional improvement methods, such as working-capital management, complexity reduction and other comprehensive tools.

To support a rapid and in-depth assessment of the main functional excellence areas, Arthur D. Little has developed three cross-industry benchmarking studies¹ in cooperation with the University of St. Gallen (CH) that are repeated every 18 months.

The benchmarking studies focus on one excellence area at a time. They are being conducted with more than 500 top European companies including a broad spectrum of organizations (turnover: ~150 – 70,000 Mio. Euro) in different industries (e.g. automotive, chemical, engineering, manufacturing, consumer goods, healthcare, **TIME**² and other industries). This allows participants to benchmark against innovative best practice developments in their own industry as well as to compare to cross-industry benchmarks and best practices.

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¹ PPE – Purchasing Performance Excellence, SPE – Supply Chain Performance Excellence and MPE – Manufacturing Performance Excellence
² technology, information, media, electronics

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**Figure 1: House of Excellence 2008**

![House of Excellence 2008 Diagram](image-url)
All companies are classified in six performance categories that add up to an optimal performance excellence rating. Categories 1 to 4 are standardized through all three studies while categories 5 and 6 cover area-specific topics of relevance:

1. Key performance indicators
2. Strategy and objectives
3. Key processes
4. Organization and qualification
5. Supplier management (PPE) / Technology and collaboration (SPE) / Innovation and technology (MPE)
6. Technology (PPE) / Sustainability and risk (SPE) / Performance improvement (MPE)

To yield a distinct differentiation of a company’s performance, criteria have been identified that are crucial for excellence in each performance category. Throughout the assessment these so called best-in-class criteria are weighted to a higher degree.

In addition to the benchmark against direct competitors and foreign industries, a virtual company (called virtual star) indicates overall improvement potentials. The virtual star unifies the values of the top firm in each performance category.

This approach enables Arthur D. Little – side by side with the client – to identify major weaknesses in the value chain and provide the help required to bridge the gaps. In the process, Arthur D. Little uses cutting-edge methods that have been operationally proven in numerous representative projects. Given the diversity of markets and organizations, these approaches are then custom tailored to the particular needs of the company.

PPE – Purchasing Performance Excellence

The procurement division has an essential impact on a company’s success, one that is often underestimated. The leverage effect of purchasing-related potentials (e.g. supplier concentration, compound purchasing, life cycle contracts, supplier portfolio management or e-procurement) can be enormous.

For example, savings of one percent in direct and indirect material costs yields as much additional operational income as an increase in turnover of 20 percent\(^3\).

The PPE benchmarking survey, first launched in 2002, includes more than 500 participating companies throughout all industries. The next study will be conducted beginning of 2009.

According to the last PPE benchmarking survey of 2007/2008, companies with first-rate procurement organizations yield far better results in yearly savings (on average 15 times as much as companies with inefficient procurement organizations).

Particularly important is the cross-linking of procurement and other functional areas to unlock conjoint potentials. In addition strategic suppliers shall be identified and integrated into the company’s own workflow, thus creating real value-adding partners. Supplier portfolio management programs as well as flexible criteria are crucial to selecting the suppliers that can deliver the greatest benefits to the company. (Figure 2).

The PPE solution line offers a range of improvement programs to advance procurement accordingly. These are supplemented by innovative methods such as mechanism design, lean sourcing and green purchasing to further optimize sourcing activities and organizations.

\(^3\) Assumptions: material cost in percentage of revenue: 60%, profit margin: 3% (Basis EBIT)

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**Figure 2: Performance Excellence Web: PPE Survey 2007/2008**

![Performance Excellence Web](image_url)
Situation

With respect to the ongoing liberalisation of railway markets in Europe and tightening public budgets, a leading European railway operator was forced to evaluate possible cost reduction levers. Arthur D. Little was able to identify significant levers in procurement by performing a PPE Audit.

Solution

The team followed a three-strep approach

- Multi-dimensional bottom-up data analysis, creating full transparency of procurement spending
- Deduction of strategic sourcing portfolios for material and services groups to identify improvement levers
- Definition measures and initiatives to implement the identified strategic levers

Results

A saving potential of more than 100 Mio. EUR per anno was identified. Following the analysis Arthur D. Little was asked to support the implementation immediately for over 12 months.

SPE – Supply-Chain Performance Excellence

A firm’s supply chain faces serious challenges in balancing lead times, inventories, transportation costs and capital investment while maintaining an acceptable cost structure and meeting product delivery requirements. Thus supply-chain excellence is a fundamental driver of company results, enabling the firm to optimize its financial operating levers: revenues, costs and capital requirements.

The SPE benchmarking survey was introduced in Summer 2008. It has already attracted more than 100 companies, and these participants will benefit from the results being published during Fall 2008. The “Supply Chain Performance Excellence Winner 2008” will be nominated during the 43rd BME symposium in November 2008.

Two main questions have been addressed by the survey:
1. What characterizes top performances in the supply chain?
2. Which process innovations and structural innovations will emerge through Supply Chain Performance Excellence?

The answers to these questions provide crucial insights into the interaction of suppliers, distributors and customers – insights that will enhance a constant and cost-efficient flow of information, products, and funds.

Preliminary results show great improvement potentials for the majority of the companies: Fewer than 40 percent of the participants could be rated as having a “professional” supply chain, thus revealing a need for significant improvement both operationally and strategically among more than 60 percent of participating firms. (Figure 3).

Figure 3: Performance Excellence Portfolio: SPE Survey 2008

Arthur D. Little is optimally suited to tackle – side by side with its clients – the challenges of remedying these deficiencies thanks to its broad set of comprehensive optimization methods, which range from improving working-capital efficiency to redesigning the entire order-fulfillment process.

Situation

A global player in the consumer adhesives business was facing limited growth and reduced profits due to a recession and to increases in raw-material prices.

Solution

Arthur D. Little developed an optimization framework to improve supply-chain and on-site activities involving most supply-chain participants (production, logistics, controlling/finance, marketing, R&D, production sites and local sales units). This enabled the company to identify optimization potentials and to create a holistic implementation roadmap.

Results

The proposed master plan and improvement measures enabled the company to

- reduce processing costs by 15%
- reduce supply chain costs by 10%
- reduce inventories by approx. 30%
- improve service levels up to 99%
MPE – Manufacturing Performance Excellence

“Production” respectively “Operation” constitutes the heart of each company. Delivering goods and services in the quality, the timelines and the volume required by the customer is essential for an on-going and strengthened success of a company. In the current environment it is more than ever important to focus on the value creating steps to eliminate cost while increasing delivery quality and reliability.

Applying lean principles as a guideline and inherent mindset enables manufacturing and service organizations to achieve manufacturing excellence fast, thus resulting in absolute customer, stakeholder and shareholder satisfaction.

The MPE benchmarking survey, to be launched at the beginning of 2009, will give insights into how the best performing medium and large corporations across all industries have defined their strategies, implemented these, track performance and envision the next level of optimization. (Figure 4).

These results combined with Arthur D. Little’s profound knowledge of lean methods, process-driven organizations, performance measurement and improvement will enable discussions with the participating company on how to achieve manufacturing excellence.

Situation

A leading producer of chemical products decided to merge activities from 3 productions sites at 1 location. The given site had good performance levels but was now confronted with a larger variety of products and an increased customer base including higher quality requirements and volumes to be handled by the same workforce.

Solution

Arthur D. Little has structured the project along 3 main areas:

- process optimization to eliminate waste in all steps across the value chain
- quality performance measurement and continuous management
- accurate and flexible planning based on improved cross-functional collaboration

Results

The optimization initiative produced the following results:

- Productivity increased by 15%
- Forecast accuracy and stability improved to 95% (from 40%)
- Supply reliability increased to 90%
- Maintenance times reduced by 50%
Conclusion

The Operational Performance Excellence (OPE) Framework offers a proven set of methodologies to offset the potentially negative effects of the financial crisis. Each benchmark and best practice is supported by highly skilled and experienced consultants who are best in class and have a broad operational as well as strategic background in their primary functional excellence area – i.e. procurement, supply-chain management and manufacturing. Augmenting this expertise, Arthur D. Little’s proven side-by-side approach of collaboration with our clients enables participating companies to strongly leverage their improvement potential towards best practice to achieve operational performance excellence. The large number of our successful assignments conclusively demonstrates that an investment of this sort pays off in the end significantly.

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Arthur D. Little

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