

It's time to circle the supply chain wagons

Should you start by cutting costs or cutting revenue?



In a booming economy, companies tend to focus more on growing revenue and market share than on managing costs and operating efficiencies. But when the economy slows, they must find ways to do more with less — particularly within supply chains. For most business leaders, the first instinct is to cut costs. But is that really the best way to start? Here's an in-depth look at the issue:

	Point	Counterpoint
<p>Start by cutting costs.</p> <p><i>“Get rid of unnecessary costs across the entire supply chain.”</i></p>	It's simple. Just do it. Reduce costs and working capital across the board by reducing inventory.	It might be simple, but it's not easy. Many supply chains don't have the tools, processes, and visibility to reduce inventory levels without incurring collateral damage.
	Cut costs, not customers. Customers are a precious asset that must be protected.	Like it or not, cutting costs can negatively impact customers. If you don't consciously decide which customers to keep — or drop — you could lose customers that matter most.
	Cut costs, not revenue. When times are tough, you need all the revenue you can get.	There's good revenue, and there's bad revenue. Bad revenue generates negative returns and actually costs you money — which you can't afford in a downturn.
	The downturn might not be as deep or sustained as others think. You may only need to trim a little fat from your supply chain.	Supply chains tend to get flabby in good times. In a crisis, people are more receptive to improvement and change, making this a good time to whip things back into shape. Don't waste the opportunity by tinkering with small improvements at the fringes.
	Downturns present an opportunity to methodically reassess your fixed and variable cost structures.	Structural cost reduction is never an easy process. Downturns increase uncertainty, and any executive actions are closely followed by the organization.
	Cut R&D investments in non-core products.	Reduced R&D investment can result in a bland portfolio of products for which customers won't be willing to pay a premium.

	Point	Counterpoint
<p>Start by cutting revenue.</p> <p>“Get rid of customers and revenue streams that aren’t profitable.”</p>	Some customers aren’t worth serving. As margins get squeezed, you might find that many customers actually cost more money than they bring in.	Maintaining your customer base will give you a head start on recovery. Investing in these relationships in a downturn can yield long-term profitable customers as the economy improves.
	Some products aren’t worth selling. In boom times, every idea seems like a winner. But the additional volume and complexity increases supply chain cost and risk. Be more selective.	After pouring money and sweat into developing new products and services, it can be difficult to walk away — even if the associated revenue is marginal at best.
	You can’t make smart supply chain cuts if you don’t know which customers and products to protect.	Deciding which customers to serve and which products to offer isn’t something supply chain managers can do on their own. Such decisions need to come from the top.
	Focus your limited R&D resources on products that are most profitable today and offer the greatest potential for future growth. Feed the profitable products and starve the others.	Cutting R&D investment in promising new technologies can create a future product revenue gap that will be difficult to replace. Intelligent rationalization of R&D pipelines will allow for sustaining and disruptive innovations during a downturn.

My take



Frank Burkitt
Principal and National Service Line Leader Supply Chain & Operations

In a downturn most companies immediately focus on cost reduction. That could be a mistake. To make smart cuts to your supply chain, you should first understand which elements represent the core of your business. Which customers are the most profitable, and which are expendable? Which products do customers truly care about, and which are just window dressing? What level of service quality do key customers need and expect?

Ironically, the best way to start cutting costs may be to start cutting revenue — specifically, the “bad” revenue that undermines your profitability. Decide which revenue streams are not worth preserving, and then target cost reductions accordingly.

The idea of cutting revenue in a downturn might seem a little crazy. But simply put some customers aren’t worth serving — and some products aren’t worth selling. The shrinking margins that accompany an economic slowdown often only make the problem worse. Executives need to use top-down revenue cutting and bottom-up cost cutting approaches.

Businesses derive most of their profits from a relatively small number of customers and product offerings. That’s the 80/20 rule. Protecting your profitable core is the key to surviving and thriving in a downturn. Once you know which customers and products are most critical to your business, you can start ruthlessly cutting fat out of your supply chain without fear of hitting muscle or bone.

A view from the consumer packaged goods sector

Adam Mussomeli

Principal and Consumer Products Supply Chain Leader

The current downturn creates an opportunity — and burning need — for consumer packaged goods (CPG) companies to transform their supply chain operations. It is important to distinguish between cost cutting and investment. CPG companies should cut costs, not investments. In fact, companies should invest now in supply chain capabilities that can give them a sustainable competitive advantage. Until recently, most CPG companies largely focused on revenue and market share growth, and haven't developed strong management capabilities in areas such as contract manufacturing, commodity procurement, and indirect spend. For some, basic practices, such as standardized ingredients and customer-aligned specifications for materials and manufacturing, are still relatively new.

Unless they improve their supply chain capabilities, CPG companies probably will have trouble maintaining profitability and market share. They may also struggle with other fundamentals, such as commodity volatility, environmental sustainability, food and product safety, health and wellness requirements, and conversion of grains into energy. CPG companies must focus on cost reduction to maintain profitability and fund initiatives that address trends that are reshaping the industry and marketplace.

A view from the high-tech sector

John Ciacchella

Principal and Technology Industry Leader

High-tech companies try to improve their supply chains to effectively and efficiently deliver a constant stream of new products with short lifecycles. As a result, most successful high-tech companies have competitive COGS and less need to radically adjust their operations. Radical supply chain adjustments tend to occur for an M&A transaction or to scale up a new product platform. However, hard economic times can create opportunities to improve the supply chain at the customer interface point.

One of the biggest improvement opportunities is tiered service. Most high-tech companies have implemented programs to provide different service levels to different customer tiers (e.g., gold, silver, bronze). But in a booming economy, tiers and service levels are not always enforced. Customers in lower tiers often get privileges supposedly reserved for higher tiers — things like penalty-fee order cancellations, change orders within lead times, or liberal return policies without restocking fees.

Weaning customers from overly generous benefits can be difficult. But when the economy hits the skids, customers expect things to tighten up and are much less likely to push back when existing policies are strictly enforced. As such, a downturn is the perfect time to regain control of your sales and customer service costs by re-establishing tiered service levels.

For more information, please visit: www.deloitte.com/us/debates/supplychainwagons.

For further information about this debate, please contact:

Frank Burkitt

Principal and
National Service Line Leader
Supply Chain & Operations
Deloitte Consulting LLP
fburkitt@deloitte.com

Adam Mussomeli

Principal and Consumer
Products Supply Chain Leader
Deloitte Consulting LLP
amussomeli@deloitte.com

John Ciacchella

Principal and Technology
Industry Leader
Deloitte Consulting LLP
jciacchella@deloitte.com

Related Insight:

[Is It Time to Rethink Your Supply Chain Strategy?](#)

Efficient and responsible globalization is a moving target.

[Your Issue: Supply Chain Strategy](#)

Supply chain risks threaten the viability of aerospace and defense companies.

Related Content:

Library: [Deloitte Debates](#)

Overview: [Supply Chain & Operations](#)

Services: [Consulting](#)