MEETING TODAY'S

SUPPLY CHAIN TRENDS AND CHALLENGES

Part 1: Finding New Levers for Managing Costs and Growing Market Share

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PREFACE

As economies around the world experience a decline in rate of growth, corporations are compelled more than ever to protect their earnings through rigorous cost management programs and also undertaking greater efforts to increase market share and grow beyond their traditional markets.

According to a recent IMF World Economic Outlook Update *(Jan, 2015)*, global growth in 2015-2016 is projected at 3.5-3.7 percent, downward revisions of 0.3% relative to the October 2014 update. This reflects the reassessment of prospects in China, Russia, the Euro zone, Japan, and Brazil as well as weaker activities in major oil exporters because of the sharp drop in oil prices. This is further supported by a recent report from FactSet, Earnings Insight *(Apr 24, 2015)* where out of 201 companies in the Standard & Poor's 500, more than half (53%) have reported sales below estimates to date.

This means that companies who hinged their corporate growth strategies and subsequent investments five years ago on the promise of hyper growth BRIC economies (Brazil, Russia, India and China) and oil-hungry world, would need to quickly rethink their strategies, find new avenues of investments, and protect their short term EBITDA to fund those new ventures.

There are three key components to ensure ongoing success in today's economic climate. Firstly the ability to manage costs to reduce erosion of shareholder value as this allows future access to capital. Secondly, is to identify and capitalize on the new economies and geographies which require access to capital. And thirdly, is to have a leadership and organization structure which is sufficiently agile to operationalize the new growth strategies.

In the first of our three part series, InvestKL explores what strategies are being employed to drive greater cost efficiencies while delivering value globally.

PART 1: FINDING NEW LEVERS FOR MANAGING COSTS AND GROWING MARKET SHARE

Traditionally the discipline of cost management has been to look at efficiencies within the four walls of the company, and approaches such as lean/6 sigma, outsourcing, and organizational restructuring has been the choice solutions employed for quick impact. In the same manner, companies tend to look towards brand management, innovation pipelines, and superior customer service to deliver the needed growth to keep market shares.

This first article on our series of Meeting Today's Supply Chain Trends & Challenges focuses on the issue of cost management. While the strategies mentioned above have proven effective in gaining incremental efficiency improvements, it does not take into account three trends:

1) Goods and services are increasingly mobile, given the increasing liberalization of trade and global commerce. This means companies are no longer competing with local or even regional competitors but often have to address competitors coming from half way across the world;
2) Costs of adding value to a product or service is highly dependent on components such as labor, power, infrastructure, and cost of capital which differs greatly from one geography to another;
3) Barriers of entry into businesses continue to decline as capital, talent and technology becomes more accessible.

Today's best in class companies (BICCs) are going beyond the traditional approaches to managing costs and looking towards their supply chains to deliver the added value to their businesses to remain competitive.

*The Performance Management Group's (PMG) research reveals a relationship between supply chain performance and superior financial performance. According to PMG's survey data, BICCs' average annual sales growth is approximately 50% higher than that of other companies in their respective industries, and BICC's profitability is about 20% higher. BICCs also demonstrate better asset turnover, with performance about 50% better than the industry average (Cohen & Roussel, p.214)**

**Source: Strategic Supply Chain Management, 2nd Edition, The Five Disciplines for Top Performance, Shoshanah Cohen & Joseph Roussel, 2013*

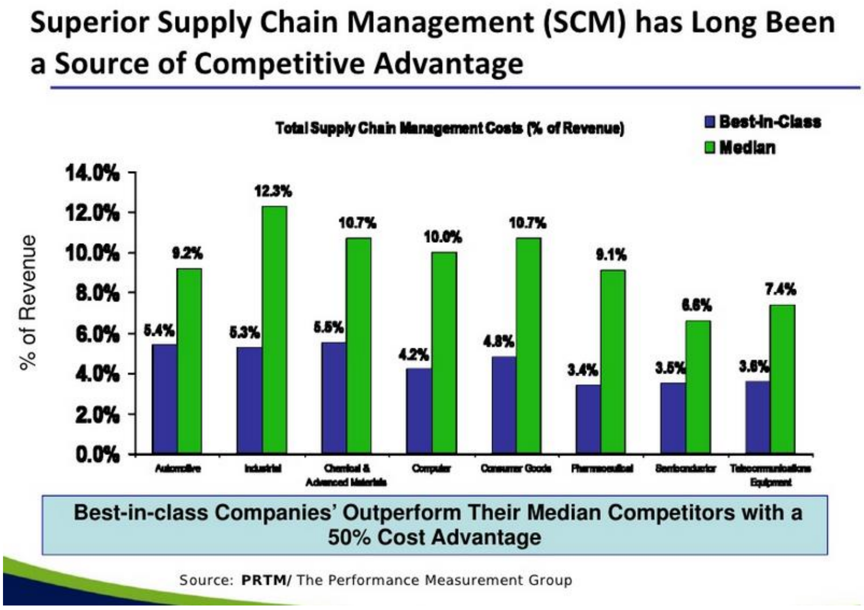

Figure 1: BICC's demonstrates better asset turnover
*(Figure 1 is derived from Supply Chain Council, Francis, 2010)^*

While companies typically compete on four basic factors: innovation, customer experience, quality and cost *(Cohen & Roussel, p.3)**, the three factors other than cost is often attributed a certain value priced in their product or service. Often there is a limit to what a client would pay for that added experience, quality or innovativeness and hence, each business regardless of their competitive strategy would still need to drive efficiencies to maintain and grow their market share.

The first step to driving additional efficiencies out of a company's supply chain is to understand not only its core competitive strategy, but also what value-add-activities which are considered non-core within its business.

Once that is done, global partners who have an advantage on fulfilling those non-core activities should be engaged. Resources freed up as a result should be allocated to increasing the company's competitiveness in their core business.

**Source: Strategic Supply Chain Management, 2nd Edition, The Five Disciplines for Top Performance, Shoshanah Cohen & Joseph Roussel, 2013*

^Source: ocsimulation.wordpress.com

CASE STUDY: Redesigning Supply Chain To Drive Cost-Competitiveness

In 2007, a leading medical and surgical supplies company with annual revenue of USD700M based in the US known for their technology in creating effective barriers to prevent infection during surgical procedures began to face declining margins which would trend towards zero in a matter of a few years.

Although the company was competing based on quality and innovation, the price differential between commodity offerings in the market as well as pressures to better manage healthcare costs driven by the US government meant that the company needed to look deeper into their supply chains for increased efficiencies.

As the company embarked on this process, it recognized that their products' innovative quality was derived from the raw materials in which it was made of, and lesser so by the actual manufacturing of the product. While manufacturing costs, specifically labor, made up a significant part of the company's total cost structure and was a large activity, it did less in terms of delivering strategic value to the company's proposition.

As such, a strategic decision was made to relook at all manufacturing facilities, their geographies and the markets where the products were sold in and determine what changes needed to be made, which partners would need to be engaged while keeping firm control over the production of the raw materials which is the basis of innovation and value.

Towards the end of the exercise, lower labor-cost content products were maintained in Mexico and Honduras with additional investments in automation, and higher labor-cost content products were contracted to several manufacturing partners in Asia which resulted in a delivered overall cost efficiency of 15-20%. This also took into account the growing surgical supplies market in Asia.

To undertake this exercise, the company leveraged a sizable project management outfit with R&D, Quality Management, and Procurement functions in Malaysia whose role was to identify, and manage the relationships with contract manufacturers and to further develop their capabilities and technologies in line with the company's products.

Today, this company remains a market leader, is listed independent of its parent company on the NYSE, generates USD1.7B globally in net revenues and operates 12 facilities globally with 16,500 employees worldwide.

KEY TAKEAWAYS:

- Declining rates of growth in global economies are compelling companies to leverage their supply chains for additional cost-efficiencies to remain viable in their markets.
- Global competitive landscapes are changing due to increased mobility in goods and services, inherent geographic cost structures, and greater access to capital, talent and technology
- Cost efficiencies should be pursued after identifying core and non-core activities where control over core activities which provide the company a competitive advantage needs to be maintained.
- To undertake a shift in value chain activities from one geography to another, it is advisable for companies to look at having a regional project management outfit with the right functions to develop business relationships and manage change.

ASEAN, with a GDP of USD2.5T and a growing population of 633M people, continues to grow in industries such as electric and electronics, healthcare, logistics and transportation, rubber and palm oil produce and has a thriving oil and gas ecosystem. Malaysia, located at the heart of ASEAN is ranked 2nd most competitive economy and 2nd in ease of doing business in South East Asia and is the 3rd preferred offshoring location globally.

InvestKL invites companies seeking to leverage competencies and efficiencies in this region to consider locating their regional and global hub in Greater Kuala Lumpur. Contact any of our investor relations directors for more information on the link below:

- www.investkl.gov.my/About_InvestKL-@-InvestKL_Team.aspx

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