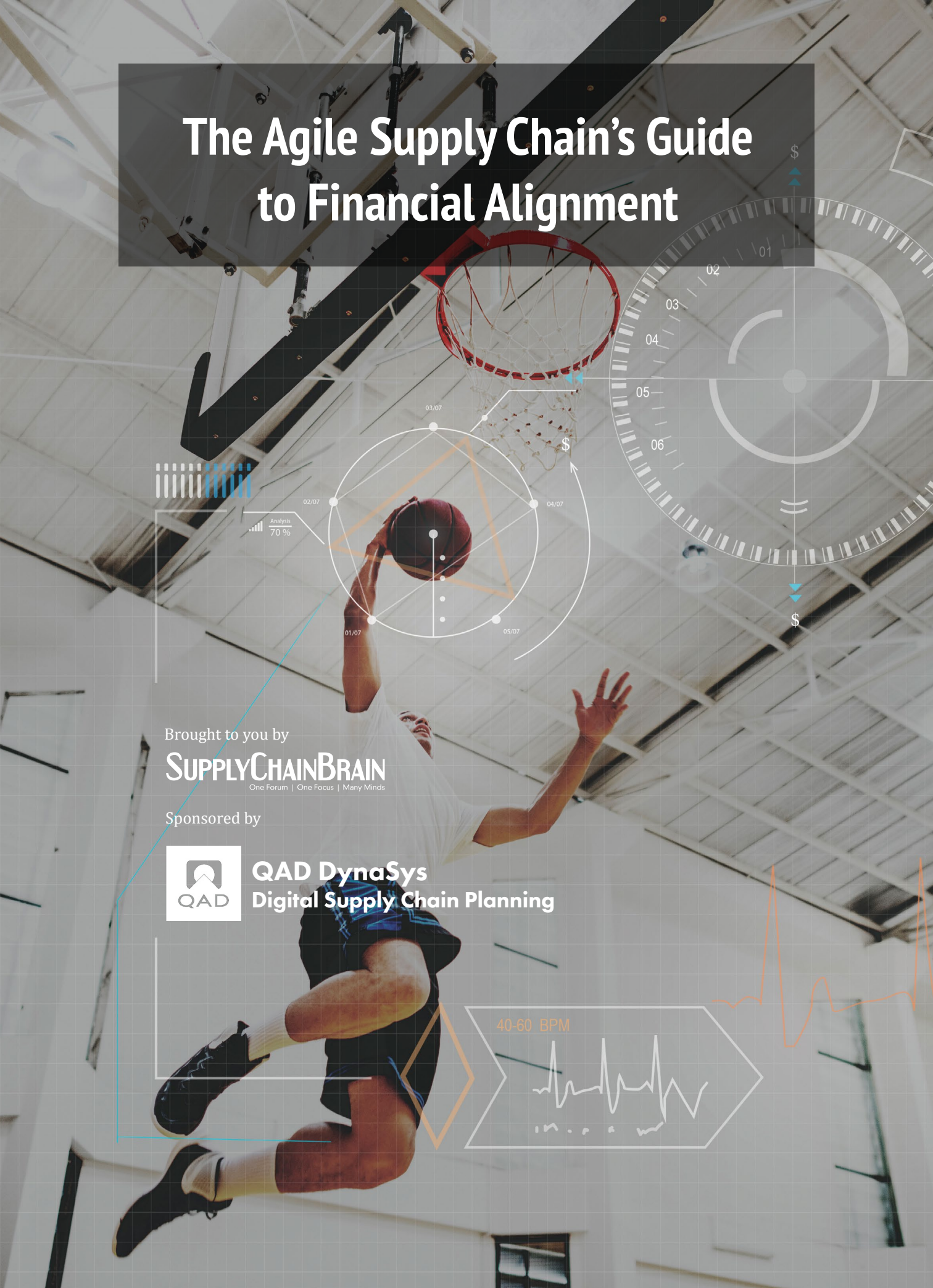
The Agile Supply Chain's Guide to Financial Alignment



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Finance and supply chain: These two essential business functions speak different languages and live in different worlds. But manufacturers need to get them to synchronize if they are to survive and succeed — and to achieve the agility and the resilience everyone strives for coming out of the pandemic crisis.

Financial people and supply-chain professionals live hopelessly discordant lives, too many think, occupying different realities and contemplating divergent concerns. But both contribute mightily to the success and the profitability of their companies, in their own ways.

It's true that finance and supply chain are often focused on different things — different time horizons, planning cycles, metrics, and working documents, to name a few. Financial budgets are expressed in terms of value and are promulgated annually. Supply-chain plans generally speak to volumes — of materials or products, that is — and are updated more frequently. Finance types tend to look at revenue, cost, and profit. Supply-chain managers drill down on capacity, inventory, and service.

Finance and Supply Chain: Unsilo Them

Leaving finance and supply chain to plow their separate fields will impact negatively on a business. Emphasizing costs alone can undermine customer-service levels. Spending on premium transportation services, while sometimes necessary to satisfy customer demand, will put a dent in profitability if used inappropriately.

To be successful, manufacturers need to get finance and supply chain to work together symbiotically, rather than be at loggerheads. The good news is that there are practices and procedures that can facilitate a successful working relationship between the two organizations.

Experts at QAD DynaSys, a provider of cloud-based digital supply-chain planning solutions, believe this alignment can play out by developing common terminologies, time frames, metrics, planning processes, and success criteria. When done right, aligning finance and supply chain creates a more dynamic, responsive, and profitable company.

The Pandemic Further Exposes the Gap

These days, the pandemic has blown to bits many an annual corporate budget. COVID-19 has profoundly impacted company fortunes, and not always for the worse. Some businesses have seen demand for their products skyrocket, and their spending and supply-chain expectations have been altered accordingly. How companies cope with this situation might provide an object lesson on how to proceed with the finance/supply chain alignment going forward.

Classically, finance people look to the company's yearly budget as their benchmark. Not everything may be carved in stone, but they measure success and failure on how their company performs relative to a document that they generate annually.

Supply-chain people view time horizons that can be measured in weeks, if not days. They determine demand through forecasting, then figure out what resources (materials, capacity, etc.) are required to deliver the correct volume of products to customers in a timely fashion.

Flip Sides of the Same Coin

"A company's supply-chain plan is in some ways the opposite side of the financial plan," says Shaun Phillips, director of product management at QAD DynaSys. "The financial plan considers the costs and constraints of things like cash and debt. The supply-chain plan thinks about how many units they need to make to fill orders, where to make them, and how to get them to customers."

Recognizing the disconnect between these two approaches, some are tempted to monetize supply-chain plans simply by multiplying the number of units being produced or shipped by their average cost or price. "That's not going to work, for lots of reasons," says Phillips.

One reason is that the finance people will simply look at these figures as costs that need to be tamped down. That's not necessarily going to be helpful, when it comes to the overall health of a business.

"Financial people need to understand that supply-chain costs bring value to the company and its customers," says Catherine Schmitt-Weber, managing associate at Oliver Wight, a consultancy specializing in integrated business planning and supply-chain management.

These varying perspectives can play out across many company activities. For example, supply-chain managers might decide to air-freight a quantity of goods from Point A to Point B in order to satisfy a strategic customer's demand.

"Of course," notes Phillips, "that's going to cost a lot more than if the products were land or sea-freighted. The supply-chain people team looks at the problem through the lens of inventory and capacity. Now we're asking them to run their operations in the most profitable way."

Come Together Through a TCO Focus

On the other side of the equation, finance needs to emulate supply chain by becoming more dynamic. "Supply-chain people are obliged to adapt themselves to changes as they arrive," notes Schmitt-Weber. "The supply chain should be flexible, so finance also needs to become more flexible."

Finance inevitably wants to optimize inventories, but excessive reductions could yield shortages that will compromise on-time deliveries to customers. Finance usually looks at inventory and material expenses in terms of cost per unit. That could be wrongheaded, from a supply-chain perspective.

"Companies with that kind of emphasis may pay for it with a reduced level of customer service," says Schmitt-Weber. "But looking at total cost of ownership allows finance and supply chain to achieve overall cost optimization. That's much better than having each function trying to optimize its own costs within its own silo."

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Cash Flow and Risk Management

The approaches taken by supply-chain operators can sometimes incur company cash crunches, but those effects can be mitigated by learning one of the key competencies of finance: risk management. "Supply-chain planning people often overlook risk management," says Phillips. "If the capacity of a resource is 100 units a week, they will plan to make 100 every single week for the whole year, without considering the possible risk of unforeseen down time."

Supply-chain professionals will strive mightily to satisfy unforecast demand. "If the demand plan expects X orders for the period and orders come in for 2X, they will often satisfy the orders," says Phillips. "They won't consider how that presents a risk to the entire plan, because they are consuming inventory and capacity that was potentially allocated for something else."

Risk management, on the other hand, goes hand in hand with financial planning. "It's part of finance's job to understand cash requirements, the cost of cash, and the risks of exposure to currencies," says Phillips. "It's possible for a successful company from an operational perspective to go bankrupt because it doesn't have enough cash on hand. Supply-chain planners procure materials from the lowest unit cost source within the lead-time often without visibility of the short payment days. Likewise all demand is good demand even if the customer payment terms are excessive. Planners do not visualize the cash impact when making supply-chain trade-offs."

Scenario Planning Bridges the Gap

Supply-chain planning software helps in the alignment process by, among other things, facilitating scenario management. When comparing plans that have lots of moving parts, it helps to rely on software that can show how changes in one aspect of a plan can impact other factors down the line. "If you want to bridge the gap between financial and supply-chain planning, you have to do scenario planning," says Phillips.

The scenario process aggregates the end-to-end fixed and variable costs over the period a company is investigating — usually a fiscal year or fiscal YTD — and computes a quick supply-chain profit and loss. It does the same for the bal-

ance sheet to determine the future capital positions for inventory, payables, receivables, and cash. "Companies require a high level of precision," says Schmitt-Weber. "So we need an approach that says, 'If I apply this change, then this will be the final result at the end of this year and next year.' "

Clearly, a plan that doesn't satisfy a company's profit expectations will be scrapped. So, too, will be one that doesn't meet supply-chain requirements.

Are Your Principals Able to Compromise?

"If the plan doesn't satisfy the core customers in the core markets and geographies, it won't make it," said Phillips. "Scenario management will help identify what a company considers to be the minimum for a viable plan, one that satisfies at least the minimum metrics across the board. Probably no one may be completely happy. The process may involve some sort of compromise."

One way to evaluate the quality of a plan is to benchmark it against industry cohorts. Inevitable conflicts will arise between considerations of revenues, earnings, costs, and cash versus inventories, logistics, and customer service. Says Phillips, "It pays to compare what you are doing to what is going on out there in the big wide world."

Another technique that helps forge the ultimate compromise, and which is facilitated by software, is to weight each of the various components. The relative importance of elements such as profitability, costs, working capital, customer service, inventory levels, resource utilization, and others will have to be hashed out between finance people and their supply-chain counterparts. The ultimate plan will reflect the values on which they come to agreement.

Your 2020 Budget Died in March

"Those who don't have the capability to run scenarios will be in bad shape," warns Schmitt-Weber. "No one knows the future, but by running several scenarios, you will be able to find your way."

The truth of that statement is borne out in this day and age of the pandemic, which has made the alignment of finance and supply chain all the more important. How many strategic planners made provisions for a pandemic in January 2020? "The 2020 budget is dead," declares Schmitt-Weber. "Whatever happened to companies, their spending is not going according to plan. The only way to understand how this year and 2021 will end up from a financial point of view is to run scenarios. Companies need to be able to react, because things are changing every month."

With international trade in turmoil, some companies might not have access to their usual suppliers. Evaluating alternative suppliers could involve, from a supply-chain perspective, their competencies and capacities, as well as financial factors such as currency risk, payment terms, and minimum orders.

"If you can't buy from China now, you don't have the luxury of waiting until the next planning process to figure out what you're going to do," says Phillips. "You need to make a decision now. If you try to decide based on supply-chain planning metrics alone, you might get lucky and make a decision that's in line with the financial aspirations of the company. But using financial metrics to support the decision will make life easier and will minimize the risk."

Many companies have been devastated by the pandemic, but others have experienced the opposite problem. "For some companies, revenues are increasing and they don't know how to answer customer demand," says Schmitt-Weber. "Aligning finance and supply chain helps them to make decisions with an understanding of the pros and cons from a financial standpoint.

"This is where companies are going and where they need to go," she adds. "They can adapt quicker when they have better visibility into the future."

So, too, when finance and supply chain work together. "The finance team will have a financial window into the plan and the production people will have a production or logistical eye on the plan," concludes Phillips. "At the end of the day, only one plan can be executed. They must all be looking at the same plan."

For more information about QAD DynaSys and our Digital Supply Chain Planning (DSCP) solutions, visit: https://www.dys.com