A Smarter Approach to Supply Chain

How CFOs are Turning Supply Chain Management Into A Strategic Opportunity
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FOREWORD:
KEEPING A CLOSER EYE ON YOUR SUPPLY CHAIN

Globalization today is less of a question and more of a given for the vast majority of companies today. Whether you’re dealing with suppliers overseas or shipping parts across the globe, your company’s supply chain grows more and more complex each day. This is certainly strong motivation for CFOs and senior finance executives to find new strategies, technologies, and tools to help them gain additional visibility into a risky situation.

Yet, many companies today continue to think of this complex operation as a way to save or make more money. This outdated mentality can actually cost your company in the end, as other firms find themselves using their supply chain as a strategic tool. Of course, keeping a close eye on suppliers—and their suppliers, too—by auditing their practices is a crucial (and expensive) proposition. But better understanding and communication with suppliers offers the opportunity to work more closely for common success.

Regulations also continue to become more complex, with a fast-expanding roster of international, federal, and state laws affecting supply chains. The cost of faulty compliance with such edicts, include enforcement actions with monetary penalties, reputational damage causing the loss of customers, and class-action lawsuits from plaintiffs on the lookout for unfair business practices.

Finally, many CFOs may have simply become complacent with their supply chain management practices. For those who fall into this boat, what seems like business as usual can turn out to be a costly error. Don’t let your oversight turn into overlooking mistakes, violations, or inefficiencies.

This CFO eBook will explore recent developments in supply chain management, including new risks and opportunities. For the finance function, taking a closer look at supply chain can yield real dividends, particularly through improved visibility and collaboration.

While suppliers can certainly create risk for your company, partnering with them more closely and finding new synergies can give your company a competitive edge. It can also lower the potential threat of penalties, legal consequences, and reputational damage as improved communication can help CFOs to know much earlier what’s happening on the ground.
The supply chain function has come a long way in the last two decades. Managing the growing complexity in sourcing products and services in a global marketplace, dealing with wild swings in the value of currency, and managing the risks associated with overseas shipping have become core supply chain competencies within most organizations.

As is true when the value of any functional area is escalating (think about the cachet today around digital marketing, social media management, and search-engine optimization, for example), clarity regarding what aspects of the function truly matter in order to ensure that a company thrives in today’s economy becomes somewhat blurred.

As all CFOs recognize, success in today’s economy relies on essentially the same factors as nearly a decade ago: maximizing the value contributed by the supply chain. Herein lies a downside of supply chain’s rise to prominence: we’ve fallen prey to the belief that reducing costs and managing risk are the single greatest contributors of value from the supply chain. Just ask anyone in a supply chain role, executive or otherwise, about the value they contribute to the organizations and you’ll find that reducing costs while minimizing risk is at the top of the list.

It may not sound like there’s anything wrong with that, but by fixating on these areas we’ve essentially lost touch with what “value” truly means and more importantly how an organization must collaborate, both internally and externally, in order to achieve it.
Strategic Shortfall

I’m not suggesting that those in supply chain roles lack the desire to contribute value. Rather, in many instances they don’t understand what “value” to the organization might actually look like.

During a recent discussion with a CPA who was responsible for managing the inventory costs of a highly technical product, I asked him to identify the single greatest obstacle to being successful in his role. He responded that the company’s “Strategic Sourcing” department was rewarded for buying products in bulk in order to reduce price, which led to a high degree of obsolescence and waste. Reducing obsolescence, on the other hand, would not only be a better way to hold costs in check, it would also help ensure that customers received the most up-to-date, modern equipment.

That’s a strategic viewpoint, but company policy drove shortsightedness, supporting tactical management of costs rather than strategic management of inventory. It didn’t take into account the impact such buying habits had on the organization and its customers. Despite the “Strategic Sourcing” department’s name, it was not acting strategically at all.

That’s not an uncommon failing of supply chain departments. The reality is that their views on what the organization, its shareholders, and its customers value are often not driven by strategic considerations, but by tactical ones. Reducing cost and managing risk are important, but not at the cost of future growth and customer satisfaction.

What Can CFOs Do?

The greatest value you can obtain from a supply chain team will come from involving its leaders in the formulation of corporate strategy. In most instances the people in these roles have had little involvement in or introduction to corporate strategy as we know it.

Providing this exposure serves not only to broaden their perspectives as to the organization’s direction, it also helps bridge the gap between their daily tactical activities and where the supply chain should focus its energy to offer the greatest value to internal and external customers.

CFOs could also take a more direct role in helping the supply chain become more strategy. As supply chains have grown in significance and recognition, its role in managing external suppliers and contractors has escalated. That is, of course, a good thing as it pertains to managing cost and risk.

Problem is, at most of the organizations I work with, supply chain professionals are seeing themselves as gatekeepers. They turn away suppliers that offer new ideas, new products, and supportive technologies for cost reasons.

That’s right: Innovation is knocking at your door and in most instances the door stays closed.

When I worked with a large power generation company many years ago, there were dozens of new and existing suppliers soliciting the organization daily. It could be anything from a new solution for how floors could be cleaned without using chemicals to technology that could revolutionize the business, but unless procurement had a requisition directing to procure such a product or service, the supplier was sent packing.

At the same time, it’s unrealistic for procurement departments to read the minds of all of their internal customers, knowing everything they want or think they might want. Large, well-managed companies like Proctor and Gamble that heavily rely on new ideas, technologies, and products have for years used an online platform called “connect + develop” to solicit the marketplace for these things.

I have helped CFOs in several organizations introduce innovation forums — designated days in which select external suppliers are invited to brainstorm with senior executives on solutions to organizational challenges and opportunities. Open your doors to new suppliers and their ideas, and watch innovation within your organization grow exponentially.

As more CFOs become involved with and oversee the supply chain, it’s crucial that they understand where shortfalls might exist and consider what to focus on in order to increase the value provided by their supply chain.

The opportunity to use the supply chain to drive organizational strategy and innovation is at your fingertips. The only question is whether you choose to empower it to deliver value.

CFO Summary

- Reducing costs and managing risk are important, but they are not the only aspects of supply chain that CFOs should focus on.
- It’s critical that CFOs and other business leaders are involved in the formulation of a strategic approach to supply chain. This approach provides more opportunities for value.
THE WEAKEST LINK: BETTER IDENTIFYING SUPPLY CHAIN RISK

As a company’s supply chain grows, so does its exposure to risk. Experts recommend that companies periodically audit their supply chains to identify vulnerable links, but the value that such audits actually deliver is up for debate, for a variety of reasons.

For one thing, an expanding list of risks means there are more things to audit. Inevitably, at large companies a lot of stuff falls through the cracks — that is, if those companies bother doing meaningful audits at all.

For another, new kinds of risks are cropping up that may escape auditors’ notice. Traditional supply-chain risks include demand and supply variability, limits on capacity, and quality issues. But those have been joined in recent years by such considerations as greater customer expectations; ever-increasing global competition; longer and more complex supply chains; increased product variety with shorter lifecycles; and security, political, and currency risks, notes Paul Myerson, professor of practice in supply chain management at Lehigh University.

One evolving area of risk is proving particularly vexing: the sourcing (inadvertent or not) of objectionable products or materials, such as those containing ingredients that have been targeted as hazardous to health, mined or produced with the use of slave labor, or sold to finance violent conflicts. In the last few years, particularly since 2013, a wave of jurisdictions both domestic and global have enacted laws and established regulations aimed at preventing the distribution of such products and materials. The newest major one is the United Kingdom’s Modern Slavery Act 2015. Even some individual U.S. states and, in the state of New York, three counties are now regulating the ingredients in consumer products.

Companies are still catching up to the realities of those requirements. “Most U.S. companies do not know who their first-tier, direct suppliers are getting their raw materials from,” says Maureen Gorsen, an environmental attorney with Alston & Bird who has a specialty in helping corporate clients with supply chain audits. “Something could be in what they’re buying that’s not allowed, and without [sufficient auditing] you could wind up with a damaged reputation and lost sales because of boycotts.”
Floored by Formaldehyde

A recent reputational hit via supply chain was suffered by Lumber Liquidators, a billion-dollar flooring retailer. On March 1, CBS’s news program 60 Minutes outed the company for allegedly selling Chinese-made laminate flooring that contained levels of formaldehyde that were 20 times over the safety standard in California. The company’s stock, which had closed at $51.86 on Friday, February 27, opened the following Monday at $38.26 after tanking in pre-opening trading. By November 10, the stock had fallen to just under $16. Lumber Liquidators also has potential legal troubles, although the extent of those was not yet known at press time.

Other potential consequences of such lapses can be devastating as well. In addition to government enforcement actions that can lead to monetary penalties, they include getting dumped by retailers, being shamed on the Internet (with nongovernmental organizations highlighting the noncompliance in their reports, for example), and becoming a target of plaintiffs trolling for unfair business practices.

For the most part, such risks are greater for large companies with highly recognizable brand names. Apple, McDonald’s, Nike, Sears, and Walmart are among those that have suffered business setbacks resulting from noncompliance within the supply chain.

But while large or midsized companies that do have exposure to supply chain risk may comply with laws and regulations, many are not very enthusiastic about putting much extra effort into audits. Like so many aspects of corporate strategy, it’s a cost-benefit question: How much money can we justify spending to audit the supply chain beyond what we have to do to be compliant, and what are we going to get for that?

Companies are likely to spend for audits of risks whose potential financial impact they can quantify, and otherwise do as little as possible, according to Gorsen.

“As a lawyer, I try to sell prevention services,” she says. “But not many companies want to buy them. They’re expensive. It’s like when a plumber tells you your pipes are getting old and you might want to replace them. You say no, but then they burst and you’re in hot water. People will not usually [spend much on audits] until they have a catastrophic failure, or in some cases one of their competitors does.”

That’s part of the reason why the term “supply chain audit” (some practitioners prefer “risk assessment” or “risk management”) can be defined so many ways. Simply sending a letter to first-tier suppliers asking questions about their compliance activities could be considered an audit. At the other end of the spectrum would be making regular, unannounced inspections at all relevant supplier locations, like factories and distribution centers. That full-blown scenario is extremely rare, though, says Gorsen.

Imperfect Fulfillment

One particular trend that’s ramping up the need for audits of overseas distribution centers is the rapid growth of online shopping. At a brick-and-mortar store, a customer shopping for, say, a University of Michigan jersey can see and touch the actual item. If the customer goes online and the order goes through a distribution channel that may include a facility in Asia, there’s a chance that a Michigan State University jersey will be erroneously shipped.

What companies need to do a better job of monitoring is the quality of the supplier’s system for matching the correct bar code to what’s in the box. “Understanding the capabilities of suppliers in high-churn bases on foreign soils can be quite difficult,” says Glen Goldbach, a principal in the supply chain practice at PricewaterhouseCoopers. “We’re seeing more and more of these order fulfillment problems. The supply chain must become more precise because of customer choices being made virtually.”

PwC measures actual performance by comparing it with what it calls “perfect fulfillment,” meaning the customer got the shipment on time and according to all applicable requirements, like having the right number of units. The firm is seeing a 1% to 2% performance degradation between what suppliers commit to and what they deliver, most of it due to incorrect product-barcode matching. “It’s a regular issue across a number of industries,” says Rodger Howell, a principal at Strategy&, the management consulting firm (formerly Booz & Co.) that PwC acquired last year.

Another set of trends, including an increase in geopolitical risk and the growing frequency of natural disasters, is making business-continuity plans—for companies and their suppliers alike—more important than ever. But to say that there’s room for more vigilant audits of suppliers regarding
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this issue would be an understatement. “We’ve done a lot of research on this, and the number of companies that know whether their tier-one and tier-two suppliers have continuity plans in place is incredibly low, in the single-digit percentages,” says Goldbach. Companies should have a program in place that sets forth their standards for business continuity plans, he says, which should be well known and understood throughout the supply chain.

Supplier KRIs

The biggest current CFO trend in the supply-chain arena is finance chiefs becoming more involved in up-front due diligence on the financial viability of key suppliers, says Christopher Monk, a managing director at Protiviti and a member of the firm’s global leadership team for supply chain solutions. Because of CFOs’ involvement, some of the modeling being used is getting much more robust, mostly at mature, best-in-class companies, Monk says. “It used to be that you ran a liquidity ratio, took a quick look at the P&L, and you were good to go. Now you see a lot more advanced analytics around things like Z score, which is a bankruptcy indicator.”

Predictive analytics using key risk indicators (KRIs) can help tip off a company to looming financial troubles at suppliers. Say you’re supposed to receive 1,000 pounds of dirt at a dock at a specific time every month. If the shipments begin arriving late or being less than 1,000 pounds, it can be an indicator of troubles ahead. “Sometimes these KRIs may show up quarters in advance of the issue being so catastrophic that the supplier tells you about it,” Monk says. “They allow you to initiate conversation and look at other strategies, like qualifying a new supplier or investing in the existing one to keep it afloat.”

But smart supply chain decisions are not always based on quantitative analysis. Sometimes they’re based on the opposite: gut instinct. Chris Good, managing director of consulting firm Conway Mackenzie, recalls an incident during his former post as a purchasing executive at a large automaker. “We were looking at buying some drive shaft tubes out of Israel,” Good says. “It was great technology. But we decided not to do it,” because of the constant threat of terrorism, he says. “We didn’t need drive-shaft tubes from Israel that desperately. It wasn’t the most exhaustive analysis ever done.”

CFO Summary

• As your supply chain grows, so does your risk exposure.
• While traditional supply chain risks continue to be a concern, there are also newer risks like sourcing, which may attract an auditor’s attention.
• Unfortunately, overlooking these risks can result in a hit to your company’s reputation—one of its most valuable assets.
• To combat these concerns, finance chiefs should be involved from the beginning in the analysis of any potential supply chain risks. In particular, finance should take a close look at key suppliers and flag any issues.
What have your suppliers done for you lately? Or, a better question might be: Have you partnered with your suppliers to drive value?

The former is aligned with an outdated view of suppliers as mere commodity vendors: squeeze them for cost reductions and hold them accountable to deliver. The latter addresses what more enlightened companies want from their suppliers today: a strategic relationship and partnership to drive value for both organizations. With busy agendas, stretched employees, and insatiable demands, we must recognize the value add of supplier partnerships and should hold suppliers to higher standards. But it’s also up to companies to create an environment where suppliers can thrive as a strategic asset.

So how can suppliers provide strategic value for your company? Let’s first consider your value proposition. You are selling your products and services, and your suppliers handle either a piece of the product/service execution or delivery of the products and services, or possibly both. How can you work together to drive more value to your end customers?

The first answer to that question is another question: have you asked your supply chain for ideas on how to innovate and drive greater value in your customer value proposition? While this may sound like an oversimplified response, recent innovation market research conducted for “Advancing Innovation: Galvanizing, Enabling, & Measuring for Innovation Value!” (published today, Dec. 14, by the Institute of Management Accountants) shows that only 31% of those surveyed have asked that question of their suppliers.

Many companies approach innovation as an internal process, and some even treat it as a secretive initiative. But the research suggests that 50% of your ideas should come from outside the company. So who better to ask how to best innovate your offerings and your overall value proposition than your suppliers? Many suppliers want to be innovative and drive more value, creating a win-win scenario — not the old-school, win-lose relationship inherent to “vendor management,” where suppliers are seen as only providing a commodity at the lowest price.
Recognizing the potential value of partnering with suppliers for support and thought leadership is only the first step. The next is figuring out how to solicit their ideas, which has a range of possibilities, including:

**Holding an ideation workshop.**

This is a straightforward tactic. You can initiate these workshops with one of your suppliers to discuss current problems and opportunities, where the supplier may be able to contribute more value to your total offering. Maybe it has new technology to bring to the table, maybe it has another customer benefiting from a different business construct like a subscription model, or maybe it simply has additional benefits it can deliver.

**Utilize technology to enable crowdsourcing.**

Why ask one when you can ask them all? A more rigorous approach, crowdsourcing allows you to solicit thoughts and ideas from multiple suppliers simultaneously. Through the use of technology solutions like Spigit, you can digitally post a business challenge to your supplier community or ask for specific ideas to drive more value for your customers. Suppliers can submit thoughts and solutions to your request and, depending on how you configure your crowdsourcing tool, you could allow multiple other collaborative aspects to the request. For example, all or a select group of suppliers can submit ideas, and others can “like” or vote on the idea from a standpoint of likelihood of success, value creation, differentiation, etc. This also creates the potential for suppliers to create an alliance, working together to find joint solutions for your organization’s toughest problems. This creates open communication that may have otherwise been impossible across vendors.

Until a few years ago, business was not conducted this openly, and we did not have the tools to collaborate at scale. Today, we can and already do use many technology solutions to quickly solicit, evaluate, and test innovation ideas to create value — even before beginning to execute the ideas. Ask yourself: are you part of the 50% capitalizing on your supplier relationships. And what value are you leaving on the table because you simply haven’t asked?

**CFO Summary**

- Rather than simply looking for cost savings, companies today are seeking to develop strategic partnerships with their suppliers.
- Look for opportunities to partner with your suppliers for additional support, innovative ideas, and more valuable opportunities.
- There are many ways to get valuable ideas from your suppliers, including initiating brainstorming sessions and crowdsourcing ideas through collaborative technology tools.
Digitization and the Internet of Things are new buzzwords in the supply chain arena. But the key to applying these concepts to achieve business success is ensuring that digital innovations in supply chain operations are maximizing efficiency — and, by extension, profits — instead of just implementing “tech for tech’s sake.”

CFOs may not directly think of digital innovation as their purview, especially not as it concerns supply chain operations. However, when others in the company get swept up in the hype and start making the case for Big Digital, the CFO, who’ll have to write the Big Check that comes with that, might want to push for an alternative approach.

One proven approach includes what A.T. Kearney calls “digital sprints,” events similar in spirit to hackathons where supply chain, manufacturing, and project managers collaborate intensively in competition with other teams to brainstorm digital initiatives that will enhance an organization’s supply chain. We call them “digital sprints” to underline a bias toward quick actions and corresponding learning.

A number of organizations — both companies and universities — are conducting such events, but under different names. There are also broader initiatives aimed at fostering digital innovation within the manufacturing space, including, in the United States, the Internet of Things Consortium and the Industrial Internet Consortium.
While hackathons are well known by app developers and venture capitalists as ways to develop new software technology, digital sprints within the supply chain space seek to come up with working prototypes of new products, new manufacturing processes, etc., under a “start small, fail fast, iterate and pivot, and scale fast” model. Large organizations that are implementing these events, relying on both internal experts and collaboration with third parties like Internet consortia and government-sponsored organizations, are at the forefront of the digital industrial revolution.

Digital sprints are more efficient and cost-effective than other approaches that companies have been following in pursuit of digitization in the supply chain space. One common approach to the digital supply chain is to hire or appoint a Digital Czar (aka chief digital officer) to keep track of and study the most recent digital tools and trends and translate them into potential opportunities. Another traditional yet often ineffective approach includes having the IT department take the lead under the assumption that it first needs to “connect everything” before taking action.

Digital sprints, with their collaborative, action-oriented approach, are well suited to push through the hype and get to real, tangible outcomes without companies having to predict the future or, even more difficult, rewire their entire IT infrastructure. Initiatives like the Internet of Things Consortium and the Industrial Internet Consortium seek to dramatically step up digitization in manufacturing through collaboration and brainstorming innovative ideas within the space. They promote “testbeds” for quick action — in essence digital sprints — that produce case studies and proof of concept for digital experiments that lead to improvements in safety, energy efficiency, overall operating efficiency, reduction in cycle times, etc.

General Electric and Cisco are combining resources to provide an end-to-end solution, from the machine interface to the cloud, that can be used for deploying GE’s Brilliant Manufacturing to introduce digital innovation to the supply chain and manufacturing space. GE has a new rapid innovation methodology branded “FastWorks” that is predicated on building imperfect early versions of new, digitally enabled products ranging from light bulbs to gas turbines to refrigerators, releasing them to customers to get feedback quickly, and then “pivoting” or adapting the products where necessary.

Digital sprints require a startup mentality, rather than the typical Lean Six Sigma mindset that is pervasive in supply chain. They benefit from a skunk works-like setup where a small group of people work together in a non-hierarchical, unconventional way with minimal management constraints and a high sense of urgency.

Four Steps to Successful Digital Sprints

Start Small
Digital sprints involve a series of modest “experiments” that contribute to addressing earlier-identified pain points or opportunities and try to solve the problem in nonconventional ways. For example, companies can organize hackathons where informal yet focused teams work on well-defined problems over a pizza-fueled weekend and generate a range of solutions. These solutions are then evaluated against a set of clear criteria and metrics to objectively gauge whether digital solutions can be successfully deployed to address the pain points or opportunities.

This approach typically generates promising ideas or concepts that can then be further funded on a shoestring budget to generate proof of concept. They should be done, at least initially, outside of the legacy IT infrastructure, which is often ill-suited for digital applications. Google Ventures has adopted a similar concept, called “design sprints,” where several ideas are pressure tested within a week to determine viability.

Fail Fast
Experimenting in a controlled manner can be a quite useful way to successfully prove or disprove the validity of certain digital concepts and approaches. Inevitably, some experiments will fail. But the key is to fail fast with minimal investments and to learn from the failures.

Take, for example, wearables, devices connected to the Internet or to other devices that are worn on the body and can be used to enhance communication to and from the users. Smart glasses, voice control headsets, fitness bands, smart watches, etc. are all “wearable” consumer applications that have genuine applicability in manufacturing, provided they are properly adapted (i.e., made more robust, explosion-free, down-featured, etc.) to work in industrial environments.

There aren’t yet many applications readily available on the market to be used in manufacturing plants, but manufacturers and potential vendors
are experimenting with some of these devices to test their potential benefits. For example, wearables can provide traceability of parts, ingredients, and process steps, they can improve safety by monitoring air quality or temperature or even by communicating with robots and machines to avoid collisions, and they can allow you to track movements of operators, which you can use to optimize the location of their tools and parts.

**Iterate and Pivot**

Experiments typically require several iterations before definite conclusions can be reached. But at this stage enough should be known about the idea to commission pilots and validate the solution. Successful pilots can then be considered for “soft” integration with factory IT, if that is required to get them operational. GE’s FastWorks methodology is a good example of the “iterate and pivot” principle.

**Scale Fast**

Once the proposed digital solution has a quantified business case with successful validation in one or more pilot implementations, you can now make the decision to invest in enterprise rollout, using the learnings from the process to accelerate the execution and, if warranted and required, to selectively rewire legacy IT systems.

This approach prevents companies from getting overly enamored with “bright shiny things” that ultimately contribute little to the business. It also keeps them from making large-scale investments in company-wide rollout and/or IT integration before the benefits are clear and the investments can be justified, to skeptics and shareholders alike.

In summary, CFOs should look to promote and adopt digital sprints if they want to be at the forefront of the industrial revolution in supply chain.

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**CFO Summary**

- Hackathons can foster collaboration between your company’s managers and suppliers to develop innovative ideas for improving your current supply chain practices.

- Digital sprints, another term for hackathons, allow teams to conceive, develop, and implement ideas on a small scale. Even if these ideas fail, the enterprise has not invested significant time or resources and can move on to other ideas quickly.

- These experiments may take several iterations, but successful pilot programs can lead to scalable solutions in the future.
CONCLUSION: OVERCOMING SUPPLY CHAIN CHALLENGES

Supply chain management has been a top priority for the finance function for many years now. But as risks continue to increase, regulations tighten, and chains grow ever more complex, CFOs and their teams are paying even closer attention.

Fortunately, there are more opportunities than ever before to not only avoid potential oversights but also to capitalize on the strategic opportunities offered by smarter supply chain management.

To avoid the myriad risks that crop up with supply chains today, it’s critical that finance plays an active role in identifying and planning for potential hurdles. In particular, take a close look at your suppliers and audit practices, as they can make your company a target for very costly violations.

But there are also plentiful opportunities to make your supply chain an asset to the company. First, technology has enabled finance teams and their colleagues to analyze data, gather ideas, and collaborate across the globe to seize efficiencies and capitalize on growth. Second, by taking an active role in planning and analyzing your company’s supply chain, finance can ensure that these activities are part of the firm’s broader strategy, rather than simply a cost-cutting function. Take the time to work with your C-suite peers and other leaders within the business to maximize the potential of your supply chain. Whether its your suppliers, vendors, fleet, or global business partners, each of these parties can substantially contribute (or detract) from your overall success.

Sources: