

CHAPTER 1

Strong Operations Drive Growth and Profits by Adjusting to an Ever-Changing World

The COVID-19 pandemic marked the end of an era. Pandemic effects rippled through supply and labor markets, geopolitical tensions mounted, and the climate crisis increasingly took its toll. We are experiencing the biggest remaking of the global economy since the end of World War II. As with other global rewirings, such as the industrial revolution, the unleashing of the internet, and the move to offshoring, the only thing we know for sure about this new business environment is that it will be less stable than the economic conditions of past decades. External conditions keep changing—and firms' operations struggle to keep up. Businesses are realizing that they need to be more flexible. They need resilience.

Resilience Across the Value Chain

Resilience is the ability to recover quickly from difficulties. Yet in a fast-changing world, you should not recover to some previous state—because the previous state contributed to your disruption in the first place.

The world will never go “back to normal.” In the new business reality, there is no normal anymore—only continual disruptions. Thus, businesses need to adapt quickly to any type of difficulty by proactively strengthening all links in the supply chain. To do this, they need a clear operations strategy that combines business, financial, and other strategies. Wider trends are bringing companies back to basics. How do your operations work, and how effectively can they adjust?

This new imperative amounts to a fundamental restructuring of global value chains. “Lean” no longer reigns supreme. The philosophy is still important, especially in its original vision of balancing cost, efficiency, reliability, and resilience.¹ But the old, single-minded focus on *driving down costs* resulted in rigid and brittle operations. To succeed in a post-pandemic world, companies must transform. Supply chains must be more agile. Operations must be more flexible and more sustainable.

The definitions of *operations* and *supply chain* may seem self-evident, but let’s take a moment to note their relationship (see Figure 1.1). Your company starts by wanting to sell something to customers in markets. You create products and portfolios, and plan for how to make them. Suppliers make inputs to your manufacturing sites, and then your logistics functions distribute products to customers, ideally with some customer-service follow up. In a narrow sense, the *supply chain* may be only the part between the two middle segments of this figure: suppliers and manufacturing. But

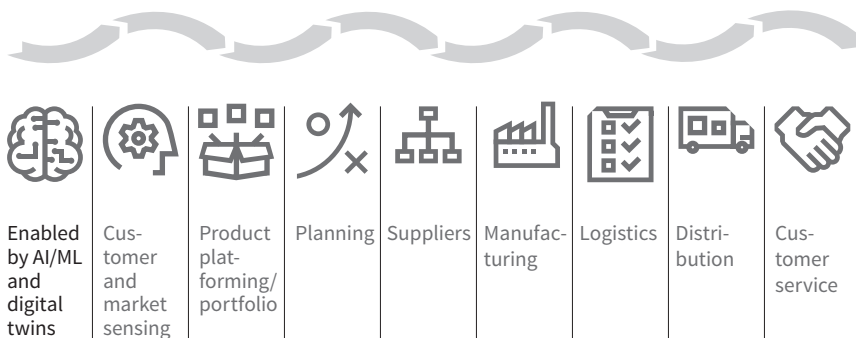


Figure 1.1 A holistic value chain includes operations and supply chains

Source: Kearney analysis.

really the supply chain, and all of these operations activities, are components of a more holistic *value chain*. To build stronger, more agile supply chains, you can become more resilient at every step in this chain. You can prioritize responsiveness as well as cost and performance.

Resilience and Competitive Advantage

Operations resilience was not necessarily valuable in the previous globalization paradigm. Then, competitive advantage often arose from customer focus or innovative products. Operations were seen as an enabler of the overall firm strategy, rather than a differentiator: To get the product to the customer as fast as possible and tailor it to their preferences. To get all required inputs to design and manufacture an innovative product. To be as efficient as possible to keep costs low.

Naturally, some firms did leverage operations strategy as a differentiator—often to achieve growth through cost leadership or shorter lead times. For example, in the 1970s, FedEx (then named Federal Express) revolutionized delivery with its then-radical idea to fly almost all packages to Memphis and then back out again. In the 1980s, Toyota engaged in a David-and-Goliath battle with US car-makers, carrying only a slingshot in the form of its unique operational culture. In the 1990s, Walmart promised nationwide consumers ever-lower prices, trusting that its attention to operations detail would make those prices profitable. In short, operations have previously been a path to profit and growth.

What is different now is that we are experiencing supply chains breaking down on a never-before-seen scale due to intensifying global disruptions. We are moving from a global economy in which supply was generally available toward an economy of scarcity. The critical inputs didn't magically disappear—the new challenge lies much more in the *allocation* of goods. For example, transport systems have broken down due to the pandemic and related labor shortages. In the resulting congestion, critical goods cannot be delivered on time. Trade barriers and import quotas are on the rise as global sentiments become increasingly protectionist. Energy shortages and adverse weather events cause production

outages and price hikes around the globe. These effects may eventually drive structural scarcity, rather than scarcity that varies by time and location. But for now, the main result is that global supply markets have become much more volatile.

Can your firm respond to these conditions by creating operations excellence that goes beyond cost optimization? If so, you will secure logistics capacity, identify and develop critical suppliers, and plan for price hikes and supply failures. And you will be able to grow in this disruptive climate, while your less resilient competitors will wither. But only if you spend at least as much effort developing and ensuring supply as you already do developing and ensuring demand.

Resilience as a Differentiator amid Crises

The 2020s so far have already presented crises in labor, raw materials, logistics capacities, and energy. In early 2020, people hoped that “short-ages” would be a simple story involving temporary closures of Chinese factories. But as events played out, the pandemic caused on-and-off closures of factories worldwide—as well as ports, distribution centers, and other essential functions. Supply chains remained in crisis. Soon other crises arrived. The Ukraine war had ripple effects on global flows of grain and natural gas. Increased US-China tensions posed risks to supply bases. And climate change had ever-more-visible, ever-more-devastating effects. Suddenly everything seemed more complex. Semiconductors became impossible to find. The supply chains for rare-earth metals and pharmaceutical inputs clashed with environmental, social, and governance (ESG) goals. Ports became congested, and an entire fragile system became destabilized. Supply chain managers often found creative solutions, but in a world of the *great resignation* and *quiet quitting*, they risked burnout.

Are these accumulating and concurrent crises just coincidence, just bad luck? Just new sets of risks to anxiously track in gigantic spreadsheets? We believe that on the contrary, they indicate deeper problems. Most companies’ operations simply were not designed to handle this degree of volatility. And so it’s time to change that operating model.

The stakes are high. All companies seek unique strengths to drive profit and growth. Resilient operations are such a differentiator—when implemented at the core of the firm. Since 2020, we at Kearney have seen highly differentiated financial returns for companies that have resilient operations. Specifically, we have worked with companies that have harvested low-hanging fruit, such as product segmentation or operational improvements within warehouses to achieve benefits of a few percentage points of earnings before interest, taxes, depreciation, and amortization (EBITDA). This book can help point you toward such projects, although you may already be familiar with some of them. What we really want to do in this book is put such projects in a wider framework and point out the benefits of moving holistically toward that framework. If you truly transform—as we have seen by supporting companies in broader transformations—you can achieve double-digit EBITDA growth.

How do companies achieve such returns? First, they transform broader corporate strategy. Second, they transform themselves. Third, they transform the careers of the people who drive those changes.

Operations as the Path to Profits

Many smart chief operations officers (COOs) are already addressing resilient operations. In a 2022 Kearney survey, 56% of leaders considered resilience a top-five priority. Nearly 80% have embedded resilience into their decision-making processes, quantifying it as a key performance indicator (KPI). Nearly 85% are altering their manufacturing footprint by reshoring, nearshoring, and/or offshoring at a granular level. To address inflation, more than half have formed alliances with existing suppliers and embraced design thinking, rather than merely passing price increases on to customers.² As Figure 1.2 shows, operations leaders can undertake projects to improve resilience at each step of the value chain.

Why are they prioritizing resilience? You can think about the answer in two ways. First, the pandemic forced firms to rejigger their supply chains on the fly. Now COOs are seeing benefits. So they're seeking to institutionalize the ideals that got them through the pandemic. The

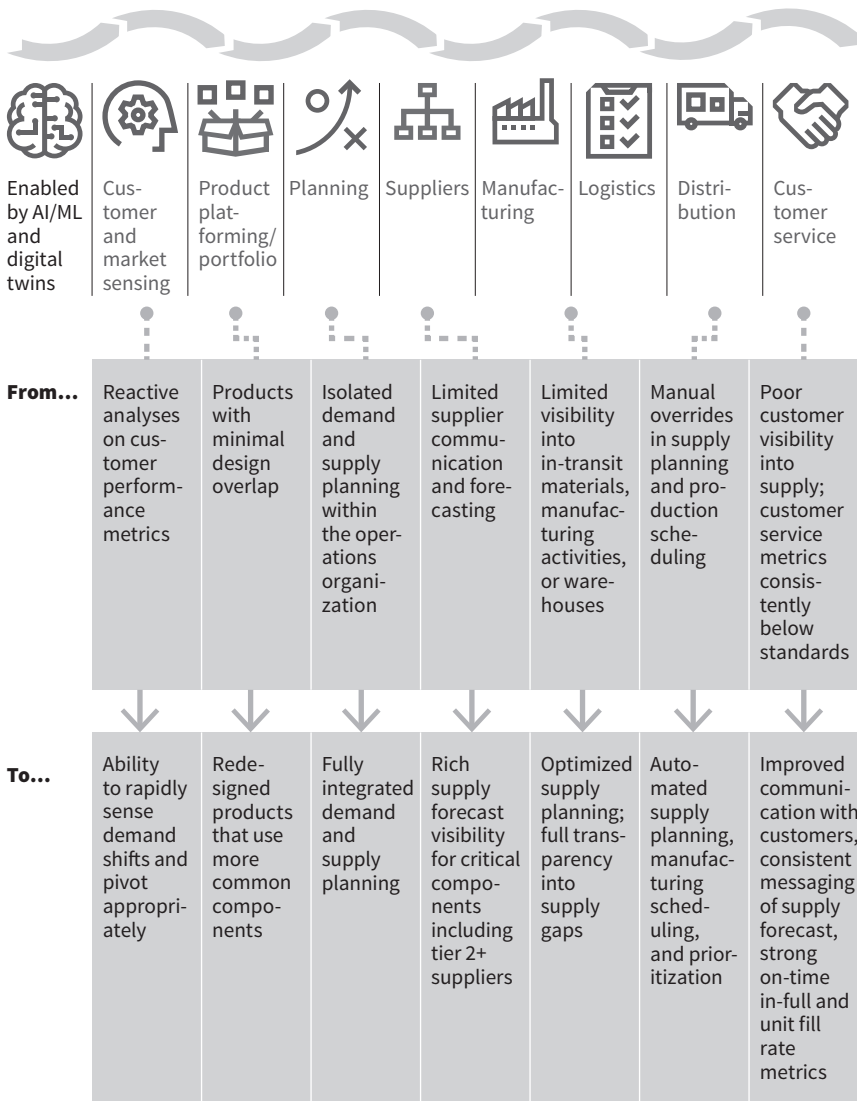


Figure 1.2 At every operations step, projects can improve resilience

Source: Kearney analysis.

rejiggering created an ad-hoc resilience, but now it's time to drive structural resilience deep into the firm. Second, leaders of the companies that employ those COOs have come to understand that operations are

today's path to profits. In other words, they have seen the value of changing not only operations strategy but also the company's values. Consider that by the end of the Cold War, many companies saw that *globalization* was the path to profits. You could move your supply chain to a low-cost country. And you could market your products to newly empowered consumers in newly opened economies. Those moves were worthwhile because they boosted profits. But they were also responses to external changes: newly available labor forces and consumers thanks to the opening of the formerly Communist world. These moves also changed companies' values. Maybe they made you more cost-focused, more aware of shareholder desires to keep expenses down. Maybe they made you more global, better able to pay attention to the varying needs of diverse global customers. Maybe they enabled you to provide opportunities for talented global employees to collaborate. These changes in values were good, and necessary—because they represented your journey on the path to profits.

You're always on a path to profits. Sometimes external changes dictate slight deviations, as in the late 1990s, when the path needed to go through the internet. Sometimes there's a blockage, as in the aftermath of the 2008 financial crisis, when it had to detour through fiscal management. If you didn't adjust your values to these detours—if you tried to operate analog in a digital world or with 1990s bookkeeping in the 2010s—your company would be in trouble. Today's detour is even bigger.

Today's myriad disruptions represent the risks of the globalized world catching up with us. We built our distribution systems without awareness of chaos theory, we built our economic assumptions without sufficient contemplation of how a pandemic could threaten them, we built our transportation and power systems by assuming away the effects of burning all that carbon. But now we (should) know better. Now we know that with a 6% vaccination rate in world's poorest 52 countries, future pandemics are possible (indeed the current one may not be over). We know that ballooning global public debt-to-GDP ratios—at 97% in 2020—could create debt crises or other risks to economic recovery. We know that many countries worry about erosion of social cohesion, especially given the likelihood of exacerbating income

disparities. And we know the risks of a changing climate: floods, wild-fires, and other extreme weather events being only the most obvious. If you try to operate lean in this risky world, your company will be in trouble.³

However, if your resilient operations mean that you can deliver when your competitor can't, you win market share. Your journey will even take you to unexpected, wonderful places. What might that look like? Some examples:

- You move operations closer to customers, and in that reshoring effort you discover design modifications that save you money.
- You leverage data analytics and artificial intelligence (AI) to bring the voice of the customer throughout your organization and gain the ability to make smarter, quicker decisions.
- You embrace sustainability as a core principle—implementing it across all functions of your company and its supply chain—and discover new sustainable designs that lead to new customers and new growth.

To be successful in such a journey to profitability, you must commit fully to it. You must transform your company with resilient operations at its core. Of course, your journey will be unique to your company. But five core principles describe success in our new VUCA world. You'll probably use some combination of them.

Five Principles of Operational Excellence

A resilient supply chain can perceive what is happening internally and externally—and quickly and continuously adapt to those conditions. We like to use the phrase *sense and pivot* (see Figure 1.3). First, you sense external signals: maybe demand is shifting, maybe supply is becoming scarce. Then, you pivot internally: you adapt your plan and strategy on the fly to better fit the new reality. You're performing against both your plan and the unplannable. Your dynamic responses make you adaptable. At the same time, you're improving your capabilities to digitize and automate, improving the speed and efficiency of your response.⁴

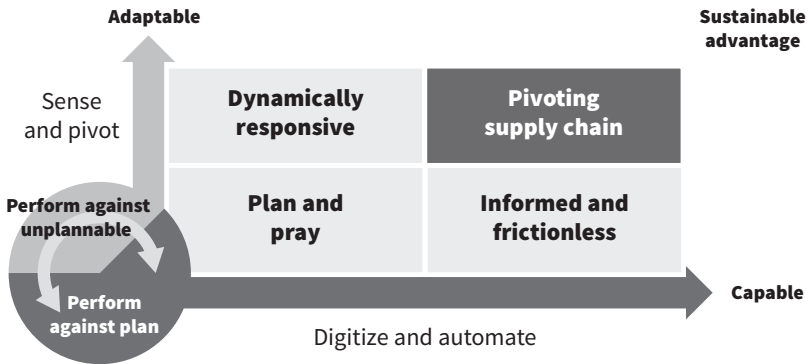


Figure 1.3 Sense and pivot

Source: Kearney analysis.

Indeed, Kearney does a great deal of work these days with our Resilience Stress Test, a customized study of a company’s performance on selected resilience indicators across eight dimensions, such as geography, suppliers, and outbound logistics.⁵ Companies use the test as a tool to focus, prioritize, and accelerate their resilience-building efforts. They look across five performance dimensions: cost, cash, service, resilience, and sustainability. We encourage them to identify and work on their weak spots, such as inadequate planning processes, overreliance on select overseas geographies, or lack of product platform and manufacturing flexibility.⁶ Sometimes that involves reshoring (see the sidebar, “Resilience and Reshoring”).

People sometimes think of *pivot* only in terms of suppliers: pivoting from one supplier to another. But the ability to pivot is valuable in responding to all types of risks throughout the value chain. For example, when Warby Parker encouraged online customers to order multiple designs of the same eyeglasses, returning the ones they didn’t like, it was enhancing its ability to pivot on the customer dimension. Likewise, a pharmaceutical company might invest in seamless omnichannel distribution to pivot in the face of advances or disruptions in logistics.⁸

This book is a strategic tour of these principles. Although this format doesn’t permit us to individualize the analysis to your specific

RESILIENCE AND RESHORING

Where do *reshoring* and *nearshoring* fit into resilient operations? For many companies, the emergence of risks has prompted a desire to bring operations closer to home. If you're starting from that instinct, you may be impatient with our ideas about resilience and pivoting.

We certainly agree that reshoring is extremely important. You can't trust a global supply chain as much as the world previously thought. In the current global situation, dependencies on distant geographies and uncertain politics are a huge issue. Your pursuit of resilience will likely cause you to reshore or nearshore some of your operations.⁷

But which operations? You can't reshore everything. You have to think through the risks and benefits. When we say that the previous paradigm was *too* focused on reducing costs, we're not saying that costs are irrelevant. We're saying that you need to balance costs against other factors. And we believe the best way to summarize those factors is operations resilience.

For example, a 10% cost savings looks good for the procurement department. But if you achieve it at the risk of losing 10% of your sales due to disruptions and supply shortages, it may not be worthwhile. Of course, those risks are hard to quantify. But it seems quite clear that they are increasing. At minimum, you certainly need to analyze them. That's what the resilience lens can do for you.

Thus, each of the principles in this book may contribute to a reshoring/nearshoring decision. Working through the principles could help you decide to change the location of a certain function because it provides you with more resilience against supply shocks, or against demand shocks, or both. Reshoring could help you build better teams, improve technology, enhance sustainability, or all or none of these options. The point is that rather than starting from a desire to reshore, you can start from a framework that helps you make these *and other* decisions. Because the point isn't reshoring for its own sake. The point is reshoring in support of resilient operations.

situation, we can share with you what we've learned. We believe the message is clear: you must make your operations more resilient—and you *can* make your operations more resilient. This is how you build advantage.

Insights Become Principles

Mastering operations resilience is clearly possible. Tools to address it include a holistic risk operating model, software packages and AI solutions, a commitment to transparency, and old-fashioned human ingenuity. But mastery doesn't happen on its own. It happens only when a company's leadership gives attention, focus, and talent to operational challenges.

Which challenges? We looked across operations to identify the areas with the most promise of return on investment. You could think of them as the fundamentals of resilient operations, or the areas of particular disruption, or the initiatives where we have noticed firms making particular progress. They can be summarized as supply chain, customers, employees, technology, and sustainability. Of course, there's overlap among them. And, of course, not every fundamental applies in every situation. Our purpose here is to lay out a philosophy of interacting with the VUCA world. As you design your own corporate strategy, you will pick, choose, and combine among these areas.

We distilled our insights in these areas into five business principles. They're not new (nor should they be). Instead their value comes from applying them to the risky business situations that require resilience.

Here are the five principles (see Figure 1.4):

1. Build resilience against supply shocks by empowering your supply base
2. Build resilience against demand shocks by using your operations to create customer value
3. Create resilient teams by leaning into new ways of working and the benefits of diversity
4. Enable resilience through technology by combining human judgment with artificial intelligence
5. Ensure long-term resilience by embracing sustainability

We'll discuss each in more detail in subsequent chapters. And we'll include examples of companies embracing resilience. Each example centers on a *leading* principle, but it also shows how the principles often

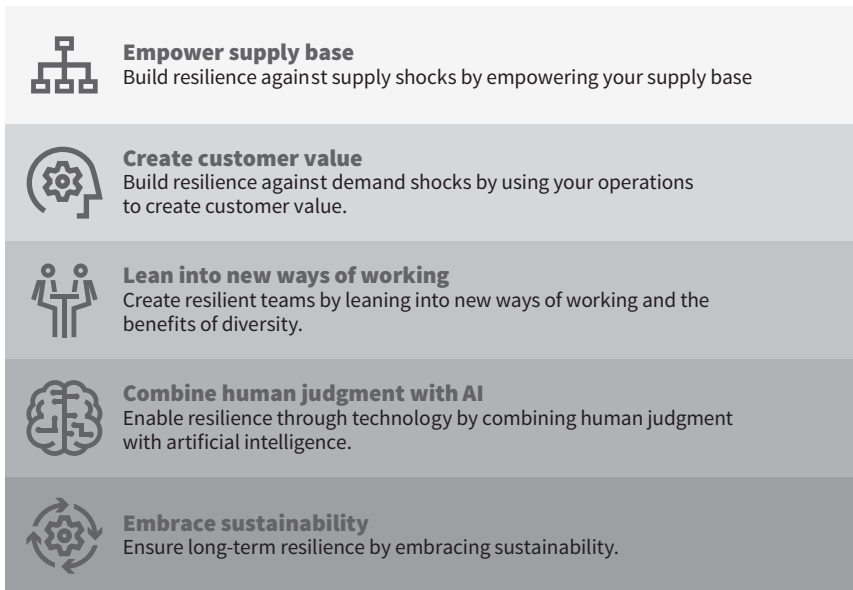


Figure 1.4 Five principles for resilient operations

Source: Kearney analysis.

combine. Because—let’s reemphasize—this is a journey. You won’t just issue an edict encouraging the firm to focus on operations. And you won’t abandon your previous strengths, be they unique products or

structural cost advantages or powerful relationships. Instead, similar to a hero setting off on a quest, you will take these (and other, perhaps not yet realized) strengths to new lands. You will face surprising threats and seemingly impossible challenges. You may at times question your wisdom in setting out on the journey. You will almost surely end it with a different inner character than when you started. But if you do indeed navigate the challenges, you will be hugely successful.

Let's dive in!

