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Guest Voices: Managing Supply Chains is Intertwined With Financial Management

MIT's Jarrod Goentzel and James B. Rice Jr. say effective supply-chain managers also are managers of working capital

One study suggested companies are "doing little to generate cash internally by optimizing how they collect from customers, pay suppliers, and manage inventory." *PHOTO: BLOOMBERG NEWS*

By **JARROD GOENTZEL AND JAMES B. RICE JR.**
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Many companies have become adept at using supply-chain management to increase their competitiveness, yet the function remains under-utilized in one vital area: working capital management.

As interest rates rise and markets become less tolerant of performers who are careless with working capital, companies may pay a high price for failing to make full use of the financial management capabilities in their supply chains.

A study recently published by consulting firm REL, a division of The Hackett Group Inc., suggests that complacency has overtaken some companies in the low-interest rate regime that has prevailed since the 2008 financial meltdown.

REL looked at almost 1,000 of the largest public companies in the U.S. and concluded that "companies continue to take on alarming amounts of debt." The study found that debt among those companies increased by more than 9% in 2014 to nearly $4.6 trillion. Companies leveraged low interest rates to fund their investments, said REL.

At the same time, "companies once again made almost no improvement in working capital management, doing little to generate cash internally by optimizing how they collect from customers, pay suppliers, and manage inventory."

> *'Supply-chain executives need to engage with the larger organization and become proactive capital managers.'*

Supply-chain management plays a key role in each of the three core areas highlighted by the REL study. In enlightened organizations, supply-chain managers are fully engaged in efforts to optimize inventory levels, collect payments from customers speedily, and to secure payment terms that benefit the company without undermining trading relationships with suppliers.

For example, supply-chain managers can support programs that extend supplier payment terms in exchange for high-volume commitments or structure incentives for early payments from customers. Proactively managing programs such as these can reduce both working capital requirements and operational uncertainty.

Market leaders commonly follow such practices, but that doesn't mean that companies simply should emulate top performers. Different business models require different inventory positions and financial relationships with supply-chain partners.

However, there are ways in which every enterprise can plug the supply chain function into their capital management programs. These will require a close working relationship with senior management.

Senior executives need to be aware of the supply chain's financial impact, and work diligently to integrate operations managers into cross-functional roles to leverage their expertise. It is no simple task to bridge the organizational silos that often stand in the way of these types of initiatives, and supply-chain executives need to engage with the larger organization and become proactive capital managers.

More specifically, operations professionals need to understand how their decisions affect the company's financial health. That requires a firm grasp of the connection between operations and important financial statements such as the balance sheet and income statement. For example, an increase in inventory might help capture additional sales revenue, but it will also increase the level of current assets.

Knowing how operational matters feed into the company's financial profile also helps supply chain professionals become fluent in the language of finance —another critical capability that supports a company's capital management efforts. In our experience, chief financial officers rarely discuss functional concepts such as inventory turns, cycle times, and service-level agreements; they want to hear how supply chain decisions influence gross profits and working capital requirements.

Operations managers who can express themselves in this way not only help the company to meet its broader financial targets, they are also more powerful advocates for their own departments. Selling a project to a senior executive is much easier when communicating in the financial language of business.

Financial fluency can also be a career booster.

Graduates of a Massachusetts Institute of Technology's Center for Transportation & Logistics graduate-level course on supply chain finance repeatedly confirm that such knowledge is instrumental in job interviews. And later on, they are more effective employees because they understand the connection between supply chain and finance and how the combination affects business performance.

The idea that financial skills enhance the value that supply chain managers bring to an organization is hardly new, of course. But when interest rates rise, as they are expected to later this year, and companies are forced to become more conscientious working capital managers, the value of financially-savvy operations professionals will surely grow as well.

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