WHITE PAPER

The System Design Architecture of
Value Maximization

DRAFT – SHORT Abridged Condensed Version for General Audience by Robert Porter Lynch and Stephen C. Rogers[1]

Introduction

There is something missing in the world of business; it's very big, very important, vital to success, at the core of great achievement, acknowledged by virtually all authorities, but avoided, sidestepped, glossed over, assumed, and thus orphaned, avoided, and replaced by things that are less conceptual, more concrete, and tangible. There is no Rosetta Stone to translate it; it exists as shards and fragments and reflections; it's about as elusive as the Holy Grail; it's the "elephant in the room" that everyone extols but virtually no one understands.

This central issue is: "VALUE."

Value is the core theme that runs through every element of business. But, despite its importance in business, "value" has been left to flounder and falter, surrounded in a grey mystique, wrapped in a shroud of fuzzy definition, with no specific discipline to navigate its course, and no system or method of manifesting its potential.

Because "value" has no grounding, it tends to wander off like a butterfly, flitting about freely across golden fields, unharnessed to corral and channel its power. Lacking precise definition and powerful discipline, "value" quickly drifts off, defaulting into more discernible discourse about "price" and "cost."

This paper aims to lay out a "system design architecture[2]" that provides definition, discipline, navigation, and rigour to "value," thus giving it a life, purpose, strategy ,and magnitude, enabling "value" to take center stage in business.

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[1] Author's Note: This is a condensed and abridged version of a much larger document. For purposes of brevity and simplicity, sections on Strategic Asset Assessment, Competitive Dynamics, Value Stratagems, Risk Management, Project Management, and Strategic Portfolio Management have been omitted.

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Author's Note: We do not expect that this White Paper will be the definitive study of Value and Value Maximization. Think of this as a *beginning,* not an end, much like putting a rocket or satellite into low earth orbit in 1962; then later, putting a man on the moon, and then exploring the solar system and then the universe beyond.

We recognize we might not have all the details figured out at this point, but we do think we have enough to break out of the gravitational hold of current thinking to move to a much higher order of thinking and concrete action. We encourage others who have sensed a similar problem to seize the opportunity and join us in the quest for a higher order of engagement for business. -- Lynch & Rogers

[2] In the Appendix we elaborate on the 12 Standards for an effective Systems Design Architecture.

Why Value has been So Elusive

Multiple Dimensions

It's no accident that Value is so poorly addressed in business.

> First it is important acknowledge that Value is kaleidoscopic – with many facets and dimensions, and frequently changing. It's also somewhat ephemeral – what's valuable to a starving man might not be valuable to someone with a full belly.
>
> Second, Value is often defined too simplistically, as the *benefit* derived from a product relative to the *cost* of that product. The *benefit/cost* equation gets more complex because the *benefit* side can include both functionality and indirect/psychological/aesthetic/environmental aspects while *cost* is much broader than just price – including total delivered cost, cash implications and the cost to own/operate and dispose of the product over time.
>
> Third, there is also a time factor. Short term value can be very different from long term value implications; latent/potential future value may be difficult to predict. Some issues of longevity or defects can be unpredictable. In many industries, Value is constantly migrating and evolving – just look at the value produced by a cell phone today versus ten or twenty years ago – value had evolved.
>
> Fourth, Value can be a factor of collateral integration – the whole is greater than the sum of the parts. Just as a barrel full of engine parts has relatively little value compared to a fully assembled and operational engine, so too must value be viewed holistically, not just in terms of components.
>
> Fifth, Value often has major strategic implications on the future of a company. Those who can produce the highest value will be more likely to survive and thrive over the long term, because customers are quick to discern good value from poor.
>
> Sixth, while we urge professionals to hold off on the price and cost issues until value is truly defined strategically and operationally, ultimately in business, all value discussion must be linked back to economics (profit, loss, revenue, cost), making money the real common denominator. Why? Because money is the only common language through which value can be understood by all stakeholders in the value stream, from investors, to suppliers, to producers, to customers, to employees.
>
> Lastly, Value is sometimes defined outside of its economics (e.g. beauty in the eye of the beholder) and at other times only in terms of its economics (e.g. value investments).

This lack of clarity and wide range of viewpoints is why the concept of value is so often misunderstood.

On the surface, these factors look like an unsolvable set of multiple simultaneous equations with multiple unknowns (recall high school algebra) where the parameters of all the inputs, ambiguities, and complexities are enough to cause most business professionals to bail out and simply default to "cost" and

"price."[3] What must be done is to clarify and solidify (through metrics and discipline) the variables, parameters, ambiguities, uncertainties, probabilities, and allowable deviances which will drive a strategy for generating competitive advantage.

By creating a framework or blueprint to tackle the multiple variables, and then applying a rigorous discipline of alignments, strategies for advantage, systems integration, collaborative innovation, and core principles and practices of lean/fast flow, we are convinced, based on our experience in the real world, that one can *maximize the value* generated both within a company, as well as what delivered by its suppliers and flowed through to its customers.

Creative Destruction

Business is an adventure-filled world of dynamic evolution – rapidly changing and fast moving. Creative destruction – the replacing the old with the new – is one of the most compelling qualities of capitalism. Innovation is not just a nice buzz word; it's the nature of the dynamic, ever-changing character of business itself. Competitive advantage yesterday does not guarantee winning tomorrow.

How value is created, delivered, and transferred to customers is pivotal to competitive. In the last decade, 4 out of every 10 in the Fortune 500 have passed into history—creative destruction at work. Study after study shows that longevity in business has more to do with how it deals with value and values, than how much money it makes in one year. The factor of value and values is often attributable to "culture." While we don't dispute this, we believe the handles and levers of culture are can be grasped and manoeuvred by the disciplined leader who seeks to understand how each control works and how its connected to the rest of the system.

Blurred Distinctions

The nature of today's business goes beyond capitalism's creative destruction – it's also far less stand-alone and far more inter-connected and networked.

Because of the inter-connections between business, there is an ever-increasing blurriness between what has been traditionally been a distinction between customers, suppliers and competitors. It's quite normal today for a company to have a quadruple relationship with another company as: supplier, customer, alliance partner, and competitor in different markets, technologies, or product offerings (sometimes referred to humorously as "multiple personality disorder").

Supply chain members often include companies that play all three or four roles at the same time. In an example from as far back as the late 1990's, Kroger was a customer of Procter and Gamble's consumer products, a competitor in many categories with its own private labels and for several years a supplier as a contract manufacturer of coffee when P&G owner Folgers. In industries like chemicals and financial services these kind of relationships are frequent today where companies supply feedstocks/services, buy

[3] We don't presume that there is a mathematical equation comparable to Einstein's Energy Equation (which takes a number of complex variables, then mathematically simplifies to demonstrate that $E=mc^2$). However, we do think that mastering the key elements of the value "design systems architecture" the professionals can handle the dimensions and dynamics of value with dexterity, agility, and aplomb, thus preventing or delaying the fast, almost knee-jerk default to "cost" and "price – the business version of "shoot first and ask questions later."

or exchange other goods/services while still competing fiercely. Technology companies can supply a set of components or software as supplier, serve as customer or distributor for the final product, act as alliance partner to develop the next generation, and competitor in another product category.

How a company *flows* value in collaborative relationships, or competes by positioning value *against* rivals is game with epic consequences.

The increase in outsourcing has also contributed to this as the producers learn a market and launch their own branded products while making items for their competition (e.g. bicycle maker Giant Manufacturing (Taiwan) now makes the Propel (used by last year's Tour de France winner) while also making bikes for Trek and Colnago, which is where they began).

To summarize: What must be done is to clarify and solidify (through metrics and discipline) the variables, parameters, ambiguities, uncertainties, probabilities, and allowable deviances which will drive a strategy for advantage. Then, applying a rigorous discipline of alignments, cooperative advantage, systems integration, collaborative innovation, and core principles and practices of lean/fast flow, design a highly competitive end-to-end (E2E) system that maximizes value at every stage of the value chain, passing that value on to the next member of the chain.

Key Factors for Addressing Value Maximization

Given the many changes in modern capitalism, we should consider the evolution of several key factors – think of these as the "levers" or "control panel" that provide an understanding and system to enable value maximization – embracing:

1. Purpose of Business
2. Economics of Success
3. Nature of Competitive Advantage
4. Impact of Value
5. Power of Trust
6. Strategic Cost➔Value Management

Each of these has enormous implications on how business is conducted and who ultimately become the winners and losers of the future.

1. Purpose of Business

Ask any group of business people a simple question: "What is the purpose of business?"

Invariably a large proportion will answer:

"To make money."

My response to that answer is: "What if you tell a customer that? What will they do?"

Usually the group will start to reconsider the answer, because a customer wants to know:

"What's in it for me?" In other words: "Is money your highest priority? If I am to trust you, you'd better care about my needs."

Most business schools have defined the purpose of business as something more akin to:

"Sell Goods & Services Sustainably[4] at Profit"

This definition, while still valid, fails to take into consideration the dramatic changes in the structure of business in the last two decades. It's high time to reconsider the business equation in a new light. Today's business is not an island standing isolated in a competitive sea, it is part of a value chain in which each member contributes to the strength of the whole. The competitive battle is really a *battle of value chains,* and the company with alliances that contribute the most value most efficiently, and adaptively in changing times, will rise to top in terms of growth and profitability.

For the purposes of this White Paper and for understanding Value Maximization, and its full scale of implications, we are going to propose the purpose of business is to:

"**Maximize Sustainable Value**" (or "Maximize Value" for short).

This definition will embrace and enable greater C*reation, Capture, Addition, Expansion, Multiplication, Sharing* and *Reaping* of value among stakeholders both long & short term. Nature of Competitive Advantage

Businesses and governments flourish when they create competitive advantage.

For business, competitive advantage can take many forms, but invariably it translates into greater value and stronger financial impact. Competition does not imply fighting. In fact, more competitive advantage is created through collaboration.

Quite often we will hear the admonition from the world of Lean Management that value is defined by what the customer will pay for.

While this is a good place to begin understanding and aligning the value chain, it is not sufficient in the long term.

Value, as defined by the customer, is the basis for creating an effective competitive strategy. Value is created for customers not by just one firm, but by an entire value chain. And value can be created, shared, divided, protected, or depleted. Competitive advantage must accrue to the key contributors of value in the chain.

Value may not be evident to the customer when it is generated, as much of value is invisible to the final product, service, or delivery system. Cost that is not linked to value can be myopic. Any members of a value chain that fail to understand the relationship between customer value and value maximization strategy will be likely to be disadvantaged in a competitive marketplace.

[4] Sustainably implies: Long Term Revenue Generation, Profitability, and Success -- Ethically/Legally & Competitively

The Battle of Value Chains

The Battle of Value Chains pits one company's value chain against another. The company whose value chain creates more value, more often than not, wins the competitive battle.

> Ultimately, leaders must deal with the fundamental issue of how to maximize the delivery of value while creating competitive advantage.

Too many of our current business and economic models are founded on the view that commercial enterprise is based on independent stand-alone organizations. This can be misleading. No one company is an isolated element; each is part of *a Value Chain,* which consists of a series of primary and support suppliers that create and build value, culminating in the total value delivered to customers.

Battle of Value Chains pits one company's value chain against another. The company whose value chain creates more value, more often than not, wins the competitive battle.

Partners collaborate within the chain, competing against rival's chains

> In the larger scope, winning the competitive game is a question of how to create an *entire value chain that is more competitive than that of other rivals*.

This cannot occur if the relationship with both our suppliers at the sourcing end of the value chain and the customers at the sales end of the chain is *adversarial*. A *collaborative* relationship with primary suppliers and customers is essential if innovation is to flow and flourish.

Value Maximization in Value Chains

This competitive paradigm calls for a business purpose to aim at *Value Maximization* that improves the value created for its *stakeholders*: its *customers*, for the *business itself*, for the *work force*, for the *investors*, and for the *suppliers* – the idea being that creating a bigger pie means there is more to go around for all the players in the game of business. This is not a far-fetched idea; Toyota and Honda have used it very successfully for over fifty years against GM, Ford, and Chrysler; their strength in the marketplace and competitive advantage is strong testament to creating a win-win value chain strategy. But value maximization is not soft; it demands continuous attention, relentless innovation, and trustworthy relationships among all the members of the value chain, because every member of the chain must be playing at world class standards, and must integrate the flow of their products, services, and delivery system into the next stage in the chain (see Figure 1).

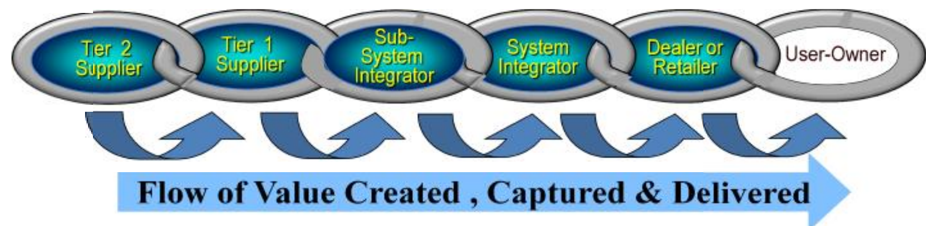

Figure 1: Typical Value Chain

The biggest problem with executing a successful value chain strategy is there has been no powerful, coherent way of designing a system for its implementation. Heretofore the process has fallen into the abyss of intuition, or propulsion via an inadequate tool-set (instead of a design architecture and master skill-set).

This paper's purpose is to highlight a system of thinking and a method for designing a value maximization system around which one can mold strategy, financial expectations, and operational excellence.

Creating Competitive Advantage in the Value Chain

Defining competitive advantage is an integral part of the value maximization equation. Competitive advantage is made up of a number of factors, the most important of which are that the company's products and work processes to "build" them need to be:

a) superior to their competition's,
b) unique to that company,
c) difficult to copy,
d) capable of lasting a long time (sustainable over time), and
e) creates core competencies or alliance competencies that are applicable to a wide range of their businesses and products.

That is why an important element of creating competitive advantage is the leadership and the people in the company that make up the culture of the organization.[5] That culture extends to external relationships with customers, suppliers and partners; if their cultures are compatible – not necessarily identical – these relationships help build a competitive advantage barrier that is hard to analyze , hence hard to copy, and very unique.

This also requires setting high expectations for people and results (tough love), while maintaining a high level of compatibility.

In a market that reinforces competition (hence *adversarial* or *transactional* value exchange), the idea of *collaboration* seems counterintuitive.[6] Enlightened leadership is necessary to turn the collaboration relationships into the delivery of competitive advantage.

To be successful Value Maximization strategy must give major consideration to enduring competitive advantage. Business is a chess match; there is never a single "best move." Strategy is relative to the customer, the responses of the competitor, and the forces of the environment.

By designing a value chain to be the best at every step in the chain, a substantial hurdle is created that becomes a series of barriers to potential competitors. Advantages can be created in a wide spectrum,

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[5] The four major determinative elements(which drive all perceptions, beliefs, and ultimately actions) of culture are: 1) Trust & Teamwork, 2 Leadership's Beliefs & Strategies, 3) People Selection & Promotion, 4) Rewards & Metrics. Maximizing Value involves the adroit interplay of these factors.

[6] In his book "Competitive Strategy," Michael Porter pits the "Bargaining Power" of Suppliers and Customers against a firm (Figure 1-1 Forces Driving Industry Competition). In other words, suppliers and customers are actually seen an either an adversarial or transactional bargain position against each other, using their leverage to gain the most by squeezing the other. He goes on to state: "The goal of competitive strategy …. is to find a position where a company can defend itself against these competitive forces (page 4). In other words, in this framework, a value chain has no allies, only competitors trying to pick each other's pockets. The flaw in this logic is that when one major player in the value chain decides to play the collaborative alliance game, all those who hold to the adversarial or transactional strategic view cannot fathom how they could be out-positioned by such foolhardiness, and are later dumbfounded to find they are no longer dominant in the industry. This is precisely what Honda and Toyota did against GM and Ford, much to their chagrin.

including cost, speed, delivery, customization, integration, friendliness, etc. Benchmarking key success metrics against other companies and value chains is valuable (see Figure 2).

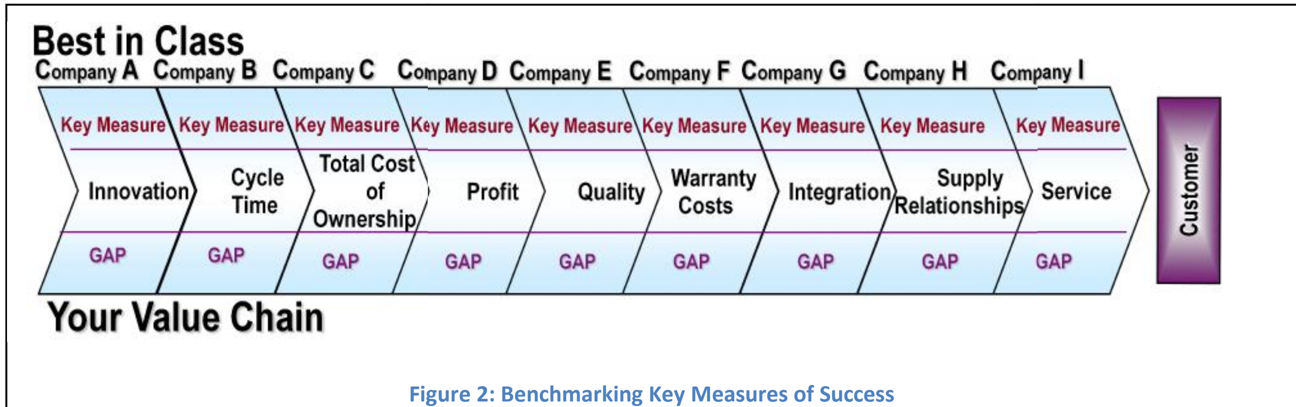


Figure 2: Benchmarking Key Measures of Success

Additionally, Value Stream Mapping is an effective tool for identifying value bottlenecks and accelerating value flow.

There are several basic options for creating competitive advantage including: low cost advantage, product differentiation, business model differentiation, systems solutions, product/service mix, and delivery systems, to name a few. (see Figure 6: Value Iceberg for more detail). World class companies have learned how to *cut costs and increase value, simultaneously*.[7]

Aim of "Strategy"

To Transform Vision & Strategic Assets into Value that Creates the Greatest Competitive Advantage with the Most Efficient Use of Limited Resources

Ultimately, Value Maximization must be directly linked to Competitive Advantage

On the surface, the "Battle of Value Chains" seems quite logical: if your suppliers are not good and pass poor quality or higher cost on to you, your inputs result in less desirable products; similarly if your customers are not good they will have problems selling to their customers (thus reducing your business) or if they are not loyal you can't count on them ongoing into the future, which will increase your business volatility.

If all this is so obvious, why are there so many adversarial relationships? If maximizing value in the value chain logically should create a bigger pie so everyone shares and strives to contribute as allies in the Battle of Value Chains, how come this does not seem like what naturally happens? We will address these questions in Section Five – the Power of Trust.

[7] Lynch, Robert Porter, Cooperation Brings Profitability, Inside Supply Management, ISM Journal, Vol. 18, No. 12, December 2007

2. What is Value?

“Value” is one of the most vaunted and exalted, and yet perhaps, the most elusive of all business concepts. Value can be a nebulous term; it is far too ill-defined, vague, sought everywhere, but almost ethereal.

At the same time it is constantly used – almost everyone talks about delivering value, creating value, exchanging value and even destroying value. Executives are urged to “create value” but given far too few guidelines, methods, or tools for its emergence. They talk confidently about it as though the definition is obvious. The problem is that nobody spends much time actually defining what value means. In a business context, the term business value is also important to define and just as vague in many people’s minds.

From the Legal Mindset

Perhaps a place to start might be the legal field since many disputes about value end up there. Legally there are two kinds of value: *value in use* and *value in exchange*.

Think of *value in use* as the utility or function of the product – what does the customer use it for/what does it do? It is the ability of the product to satisfy, both directly and indirectly, the *needs* and *wants* of the customer.

Think of *value in exchange* as what the product can be exchanged for in the market – typically money (economic value) but sometimes other commodities or services (barter or trade in kind) or even customer self worth. In this case, market value is defined and determined in an open marketplace.

This definition might be is a place to start, but it is far too limiting; there are more dimensions to consider. Every part of the business community, from supplier to customer has a different mindset about defining value; here are just a few perspectives:

From a Business Mindset

For many firms business value means all the forms of value that combine to determine the health of the company, including its supply chain’s ability to deliver strong products and services to its customers at a reasonable profit and positive cash flow. Implicit in that definition is that the product’s benefit needs to exceed the resources required to deliver that benefit.

From the Trader’s Mindset

Buy low, sell high, make money on the difference

From the Investor’s Mindset

Maximizing the Return on Investment

From the Consumer’s Mindset and a Company’s Dilemma

The problem is that most companies have customers that are balancing many types of benefits for the products and services being purchased: including buying cheap or buying the greatest benefit or buying the premium image (luxury brands) or buying environmentally friendly, or

buying for timely delivery -- but all need to have the basic need met and want to have some wants met. (Remember, needs are not wants.)

The trouble is that most companies have many customers, each of whose definition of value can include a range of potential benefits for the individual customer. Additionally, once the customer's need has been met, wants transform into new needs – creating value migration because customer expectations change.

So the practical definition of value is not constant, but changes for each customer and over time. That is why value is talked about a lot but seldom given a precise definition. It is often relative and can be both quantitative and qualitative.

From the Financial Mindset

In the ultimate game of business, however, the score is kept financially. This requires that many of the "soft" elements of value have to be translated into something that eventually impacts the bottom line despite the difficulty in measuring them.

Everything in business eventually defaults to money, costs and profits

Ultimately the issue of *value* must be tightly connected to a business' *mission and purpose* and its *customers.* All too often in far too many companies, the issue of value is given way too little attention. We aim to correct that disconnection.

3. Impact of Value

For two externally-focused professions that must range far outside the firm's castle walls – Supply Chain and Strategic Alliances – the lack of an *architecture* (system of design) and common language around "value" has created an empty hole. Corporate executives in the C-Suite intuitively sense there is largely something of value brought by these two professions, but when challenged by senior financial officers to "prove the value" by translating directly and immediately into financial terms (revenue, profit, return, etc.), the supply chain and alliance professionals are all-too-often at a loss. This leaves them "orphaned" inside their own firm, and left at the doorstep of the C-Suite, vainly begging admittance, and vexed as to how to gain acceptance from their senior peers.

What Happens without a "Value Design Architecture"

A search of books and articles about" value" reveals an almost eerie pastiche of fragmented thinking about methods, tools, cost analyses, customer demands, and economic theory, but nothing coherent, systematic, or disciplined. Learning about "value" is like the blind men analyzing the elephant, each examining a small part and proclaiming its magnitude and centricity.

Other fundamental problems are also generated by the lack of systems design architecture for value:

- Strategy, and the all-important creation of competitive advantage, are not linked inextricably to Value
- Mission, Purpose, and Operational Values/Culture are disjointed because they are not linked to Value
- Development of powerful, coherent, efficient, and highly profitable Value Chain Strategy is extremely difficult
- Cost Cutting, without "value architecture" is haphazard at best, and horribly destructive at worst.

What's more, without a systematic design framework, value is fuzzy, ill-defined, and ambiguous, thus it's implied or hedged, but not directly addressed, which causes many to lunge in desperation for "tools of salvation," such as value stream mapping, value engineering, or the latest software gimmick.

The problem of the missing "value design architecture" causes businesses to act haphazardly, to behave as independent entities rather than coherent value chains, and to divorce strategy from daily operations.

In times of stress, all-too-quickly executives to default to that which is simple and straightforward: money, costs, and profits, without careful consideration of how value is actually created, expanded, captured, transformed, exchanged, and eventually converted into money. (While translating value into money is the ultimate common denominator of business, if the leap into monetary conversion happens prematurely with knee-jerk rapidity, real value *creation* and value *capture* will be thwarted.)

To use an analogy, it's much like an ignorant farmer who knows enough to plant a seed, but understands neither how to cultivate a garden, nor how much water is too much or too little, nor how much fertilizer is optimum, nor how to rotate crops, nor how to manage the workforce ensure the maximum harvest at the best market price.

Value Maximization "Design Architecture" gives management a system and language thorough which to think and communicate, producing unified and integrated results across the Value Chain.

The lack of such "value architecture" relegates those key value chain functions that work outside the corporate castle walls -- like Supply Chain and Strategic Alliances -- to be caught flat-footed when trying to validate their efforts, because the C-Suite typically wants to convert their initiatives into instantaneous financial figures, such as direct costs, revenues generated, or profits. Even indirect costs, like *costs/risks avoided* or *total cost of ownership* or

productivity or *value chain competitiveness* are not counted toward success.[8]

Aligning Value: Dynamic Goal Shifting with Expectations

The whole idea of "value" presents some unique problems from the outset, thus defining it is problematic, but conquerable.

Value is Situational, Conditional, Relative and Multi-Dimensional.

What is valuable to one person may be irrelevant to the next. A glass of water is far more valuable to a parched person than to who's bloated -- it's worth its weight in gold to the thirsty man. What creates value in one industry may be irrelevant in another.

While *cost is single-dimensional*, *value is kaleidoscopic – moving and multidimensional*.

Furthermore, like beauty, value is often in the eye of the beholder.

All value, within the boundaries of being conditional, situational, and relative, are driven by performance metrics, operating principles, market realities, competitive dynamics, cost-benefit analyses, technical realities, customer expectations, compatibility, functional integration, and aspirational potential, among others. Understanding the foundations of value is not simple, and sometimes it's highly intuitive.

That's where talking to users, observing how people interact with product, and understanding how things fit together is so important. Value is not an abstract issue – it's functional, aesthetic, reliable, accurate, tangible, efficient, speedy, friendly, trustworthy, and other things that can be observed and usually quantified. In other words, value typically is holistic, not superficial.[9]

Where so many supply and alliance professionals go awry is not clearly understanding the complexity value paradigm and the manner in which it must be addressed and aligned in the value chain.

Value is determined more by results delivered, at which point the purchaser, user, or consumer speaks loudest. To understand value, one must first be deeply cognizant of the core value principles that apply to the user or purchaser. This requires a distinction between what the buyer "wants" and what they "need." People first buy what they *want*; then consider what they *need*. The purchaser needs to experience value when they make the buying decision, during their period of ownership, and after the product or service evolves or cycles to the next stage (either by resale, disposal, or transformation, etc.).

Internal & External Stakeholders

The value paradigm is further complicated because value must be addressed from the perspectives of both *internal* and *external* stakeholders. *Internally* the value to marketing, finance, operations, engineering, R&D, etc. must be very clearly defined so that there is a team of *internal* winners who find supply and alliances a valuable partner. Each of these *internal* stakeholders has their own unique

[8] Supply Chain and Strategic Alliances are natural "partners" inside a company. But historically there has been far too little interaction between them. I believe the fundamental reason is because of the lack of a unifying *Value Architecture* that enables them to see the synergistic potential between each other.

[9] Note: This discussion is not intended to address "fads and fashions" that come and go, whipped by marketing frenzy and peer pressure.

foundational value parameters and metrics for success. The most accurate way to ascertain an *internal* stakeholder's value paradigm is to determine what *metrics* drive their performance success. (Only when the *internal* stakeholders see that value is being generated will they consider elevate the supply and alliance positions to C-Suite status.)

Once the *internal stakeholder* foundation/teamwork has begun, the *external* stakeholder analysis (customer, delivery system, channel partners, suppliers etc.) can begin.

The predominant *external* focus must first be on *customers* – What will they pay for? What will they value? What problems do they have that need our solutions? What pressures are they under? What keeps/makes them competitive? Making the customer preeminent recognizes that the only way to stay in business is to have *revenues* – the *top line* on the Profit and Loss Statement (it's the only line that makes a positive contribution to profits).

A fool is someone who someone who knows the price of everything, and the value of nothing.

While the predominant external value focus must be on *customers,* because without them there is no revenue, the value maximization equation must also make sure the firm also appropriates a reasonable and fair share of the value. By only focusing on the customer, without understanding where the power is distributed throughout the value chain can result in all the value passing to where power is the highest (if the power-player insists on a "value grab."[10]) The joint shifts of globalization, widespread data and information availability plus reduced "business transaction friction" due to the internet has shifted a greater amount of power to the customer. Many companies' margins have been lowered by the ultimate customer's knowledge, global competition,[11] and consumer interest in customized products that can difficult to differentiate. This means that not every necessary customer-supplier relationship in the value chain will be strategic nor must it be collaborative[12] – a transactional relationship may be quite sufficient for small, one-off buying.

The central focus of the Battle of Value Chains is that all the players *align* on the delivery of value to each successive customer in the chain, while, at the same time, having clarity of how value is created several links forward to ensure *each link is creating value that increases the succeeding customer's competitiveness.*

Innovation & Creative Destruction

One of the enduring qualities of capitalism is its ability to obsolete the past and create a bold new future by innovation – the continuous replacement of something old with something new. Value plays a massive part in understanding the creative destruction of the old by the new. If something has value, generally it is

[10] In the auto industry, Toyota and Honda (the power players) have been extremely fair in monitoring this value distribution in a reasonable and fair manner, which keeps the entire value chain healthy and competitive. The same has not been historically true for GM and Ford, who only recently seem to have begun understanding this concept.
[11] For example, consumer power in buying manifests in the massive growth of a retailer like Amazon.
[12] Where collaboration is most important is in those larger, more strategic relationships where a high level of value must be created and captured. The ability to engage in collaborative approaches requires deep skills – market skills, strategic skills, negotiation skills and relationship skills; and the ability to manage non-collaborative relationships as well.

only replaced by something that has more value. Technological evolution is based on this premise. For example, in the transportation industry, horses were replaced by trains that were replaced by trucks. In the utility industry, candles were replaced by gas lights that were replaced by electric lights.

In other words:
Value is not static – it's dynamic, ever-changing, and interactive within the context of its environment.

Every business professional must have a decent grounding in the understanding of value to be effective.

Value Propositions – Transforming Value into Measurable Benefit

A Value Proposition is an essential element in how value is perceived in the eyes of the customer (where value translates into monetary flow) or internal user/team member.

Think of a Value Proposition as a "Value Made Measurable" – it always includes a *quantification* of how value can be experienced in a measurable way – in many ways it is a Value Commitment/Promise.

Value Propositions gives "aim" to strategy – direction, alignment, purpose, clarity, focus, and linkage – connecting vision to operational impact.

Value Propositions are often time dependent because, quite often value must be realized relatively quickly – short or medium term. Without a Value Proposition:

- Vision lacks grounding in reality, operations lacks focus, and customers
- Customers cannot distinguish or appreciate the competitive offering.
- Maximization of value is doomed to wander, like an explorer without a compass.

Example Breakthrough Value Proposition that United a Country

"We will put a man on the moon and bring him back alive by the end of the decade." -- John F. Kennedy 1962

Impact:
- Aligns the Value Chain
- Inspires People
- Links Strategy to Operations
- Measurable & Time Bounded

Some Examples of Value Parameters that are addressed in Value Propositions

- Better
- Cheaper
- Faster
- Safer
- Easier
- More Accurate
- More Reliable
- More Compatible
- More Integrated
- Harder/Softer/Flexible
- More Integrated
- Better Service
- Easily Diagnosed
- Reduced Expenses
- Increased Productivity
- Improved Efficiency
- Improved Quality
- Greater Innovation Flow
- Longer Lasting
- Easier to Repair
- Responsive to Needs
- Flexible Terms
- Collaborative Contracts
- Timely Delivery
- Quick Payment
- Shared Rewards
- Improved Customer Satisfaction

To gauge how little the average business student knows about value, just ask any MBA graduate student: "How do you create a Value Proposition." The vast majority will look at you like you came from outer space.

Value Stairway, Pathways & Stratagems

Value Maximization requires value chain professionals and strategists to think precisely about where and how every business relationship in the value chain creates the greatest competitive advantage, the best value delivery, with the minimum cost and the highest use of strategic assets. There are five fundamental hierarchical levels, each with value delivery pathways (each has a variety of engagement options):

1. Value Creation
2. Value Addition
3. Value Transaction
4. Value Protection
5. Value Depreciation

(more detail will be provided in a separate White Paper)

Value Pathways are the options that every alliance and supply chain leader has available for every strategic relationship. The Value Stairway (see Figure 3) illustrates the pathway options available.

Figure 3: Value Stairway & Value Pathways

Author's Note: While we are advocating there is greater Value Maximization the higher one climbs the Value Stairway, we caution not to draw the risky conclusion that the lower levels are inherently "bad" or "obsolete" to be replaced by higher level strategies and skills. To the contrary, while the lower stairway steps imply adversarial skills are generally less valuable than the higher steps, be aware not every supplier or customer has their counter-party's best interests in mind. Each step of the stairway includes skill sets that need to be maintained and used depending on the nature of the market and the relationships between members of the chain. Mastering the Value Maximization approach implies a company's ability to embrace and use *all* the strategies, tactics, skills, and relationships needed in each of the previous steps and, most importantly, it has the aptitude to know when to use each of the capabilities most effectively -- knowing how to mix and match to maximize the value possible given the situational conditions, from defending against chain members against value depreciation at the bottom to generating value at the top.

In Value Maximization, each strategic and major supply relationship should be evaluated to ensure that value is maximized in the relationship – making it more difficult for the completion to create advantage, particularly if they have a propensity/capability that keeps them playing lower on the Value Stairway.

Five Fundamental Types of Stratagems

Like a chess game, there are fundamental "moves & gambits" in operational execution that enable value to be realized powerfully and reliably. There are two dozen basic moves to implement strategy; each should be part of the basic repertoire of the Value Maximization professional; each is easily remembered, illustrated, and optimized.

With Value Stratagems, no matter what the competition, where are always options on the board for creating value and competitive advantage. Sage professionals will take be playing the game with moves in mind years in advance, building strengths that become imbedded in their culture.

Definition: *Stratagem* – plan or method to outmaneuver the competition or create competitive advantage

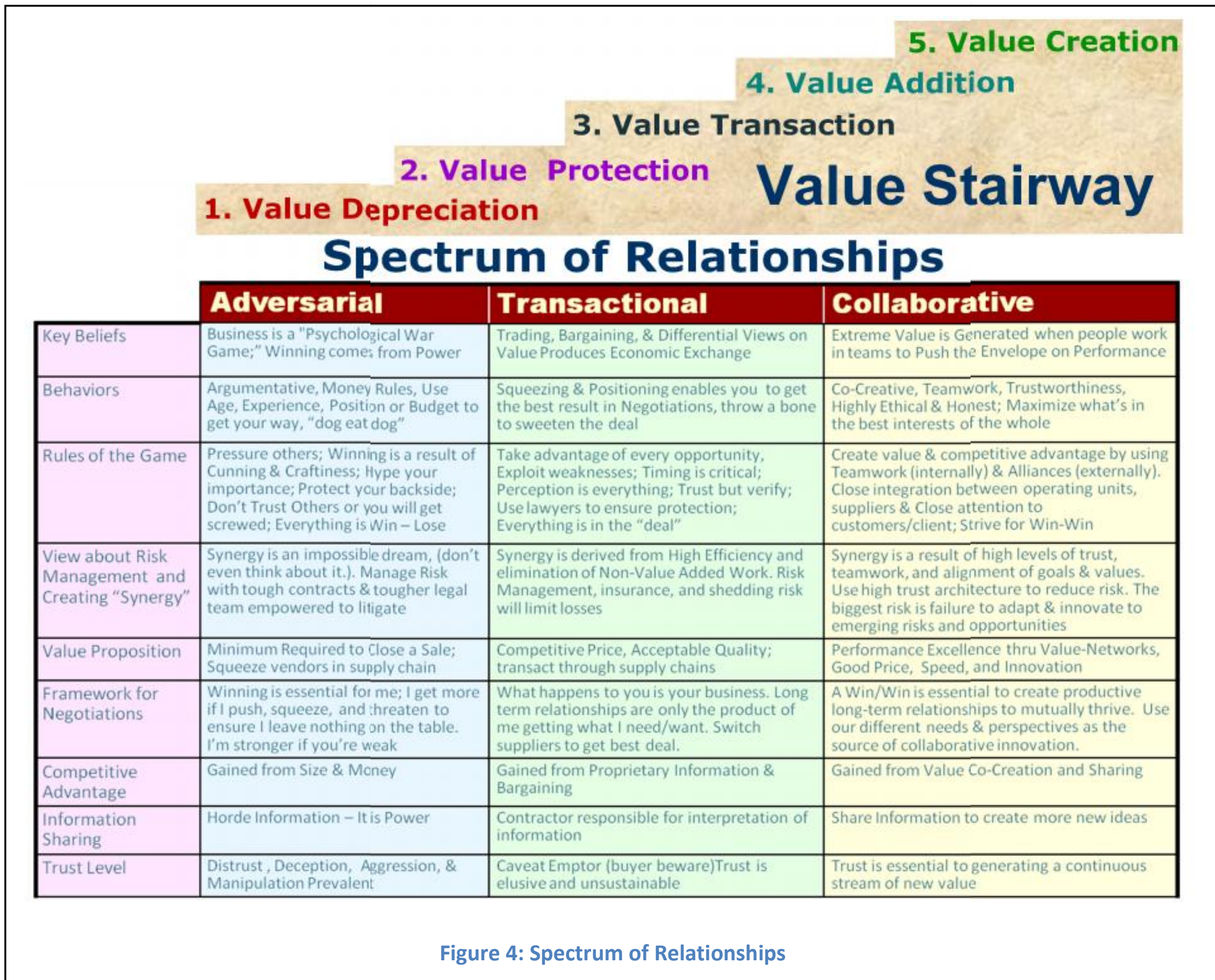
There are five basic stratagem types (each has several "gambits" for effective execution – 22 are listed here: (in a separate White Paper, we will delineate each of these stratagems in more detail)

1. ***Obsolete the Competition* -- Make the Competition so out of date it can't compete**
   a. **Breakthrough Technology**
   b. **Fast-time Shift**
   c. **Re-Invent Yourself**
   d. **By-Pass**
   e. **Change the Rules**
2. ***Collaborate to Compete* -- Form Alliances to Integrate, Innovate, & Accelerate**
   a. **Leverage Value Chain Assets**
   b. **Build Walls Brick by Brick**
   c. **Spider Webbing**
   d. **Network the Value Chain**
   e. **Innovate Using Differentials**
3. ***Beat the Competition* -- Outperform – Be Significantly Better than the Competition**
   a. **Outperform on Key Factors for Success**
   b. **Leverage Strategic Assets**
   c. **Use Competencies in Multiple Markets**
   d. **Exploit Niches**
4. ***Offensive & Defensive Stratagems* -- Attack, Defend, or Control to Gain Advantage**
   a. **Attack on Their Turf**
   b. **Buy the Competition**
   c. **Defend on Our Turf**
   d. **Control Distribution Channels**
   e. **Timing with the Winds & Tides**
5. ***Deceptive Stratagems* -- Make the Competition Believe One Thing then Do Another**
   a. **Feint**
   b. **Trojan Horse**
   c. **Tunnelling**

4. Power of Trust

Managing the human interaction within a Value Maximization framework is essential for optimum performance. *People create value*, it is not a mechanistic process; relationships are fundamental.

There are three basic relationship possibilities, ranging from *collaborative* to *transactional* to *adversarial* (see Figure 4). Any professional committed to Value Maximization must have an intimate knowledge and operational facility at managing *collaborative* relationships with agility. This is particularly important where speed, innovation, or complexity comes into play.



	Adversarial	Transactional	Collaborative
Key Beliefs	Business is a "Psychological War Game;" Winning comes from Power	Trading, Bargaining, & Differential Views on Value Produces Economic Exchange	Extreme Value is Generated when people work in teams to Push the Envelope on Performance
Behaviors	Argumentative, Money Rules, Use Age, Experience, Position or Budget to get your way, "dog eat dog"	Squeezing & Positioning enables you to get the best result in Negotiations, throw a bone to sweeten the deal	Co-Creative, Teamwork, Trustworthiness, Highly Ethical & Honest; Maximize what's in the best interests of the whole
Rules of the Game	Pressure others; Winning is a result of Cunning & Craftiness; Hype your importance; Protect your backside; Don't Trust Others or you will get screwed; Everything is Win – Lose	Take advantage of every opportunity, Exploit weaknesses; Timing is critical; Perception is everything; Trust but verify; Use lawyers to ensure protection; Everything is in the "deal"	Create value & competitive advantage by using Teamwork (internally) & Alliances (externally). Close integration between operating units, suppliers & Close attention to customers/client; Strive for Win-Win
View about Risk Management and Creating "Synergy"	Synergy is an impossible dream, (don't even think about it.). Manage Risk with tough contracts & tougher legal team empowered to litigate	Synergy is derived from High Efficiency and elimination of Non-Value Added Work. Risk Management, insurance, and shedding risk will limit losses	Synergy is a result of high levels of trust, teamwork, and alignment of goals & values. Use high trust architecture to reduce risk. The biggest risk is failure to adapt & innovate to emerging risks and opportunities
Value Proposition	Minimum Required to Close a Sale; Squeeze vendors in supply chain	Competitive Price, Acceptable Quality; transact through supply chains	Performance Excellence thru Value-Networks, Good Price, Speed, and Innovation
Framework for Negotiations	Winning is essential for me; I get more if I push, squeeze, and threaten to ensure I leave nothing on the table. I'm stronger if you're weak	What happens to you is your business. Long term relationships are only the product of me getting what I need/want. Switch suppliers to get best deal.	A Win/Win is essential to create productive long-term relationships to mutually thrive. Use our different needs & perspectives as the source of collaborative innovation.
Competitive Advantage	Gained from Size & Money	Gained from Proprietary Information & Bargaining	Gained from Value Co-Creation and Sharing
Information Sharing	Horde Information – It is Power	Contractor responsible for interpretation of information	Share Information to create more new ideas
Trust Level	Distrust , Deception, Aggression, & Manipulation Prevalent	Caveat Emptor (buyer beware)Trust is elusive and unsustainable	Trust is essential to generating a continuous stream of new value

Figure 4: Spectrum of Relationships

In our analysis of highly successful organizations over the long haul, there's a powerful and direct connection between the level of trust and teamwork a company exhibits in its culture, and the competitive advantage and profitability it creates over the long haul. The reason: collaboration produces the highest levels of productivity, innovation, and adaptability to adversity. Thus Value Maximization embraces the nature of *culture* on results, which can have a 30% impact on risk in highly complex situations and projects.

> *In complex projects, collaborative systems have five times the chance of coming in on-time and on-budget than those run in an adversarial manner.*

Why Strategic Alliances are Essential

Gaining *alignment* (fit) is absolutely essential for the entire Value Chain Strategy to work. There are three fundamental alignments that must be formulated (known as 3-dimensional alignment):

1. Strategic Alignment (Fit)
2. Cultural Alignment (Fit)
3. Operational Alignment (Fit)

Strategic Relationships are opportunities to create Bold New Futures

The best practices for these three alignments have been carefully tested and executed by the Alliance Profession[13], but not well integrated into a holistic Value Maximization strategy embraced by Finance, Supply Chain, R&D, Marketing, Strategic Planning, or Legal. Successful execution of the best practices to attain three dimensional alignment is essential for Value Chain implementation.

Teamwork, Trust, and Collaborative Innovation as Central Organizing Principles

Value Maximizations is a not just a change in business strategy; it's also a "cultural change," which traditionally is not an easy adjustment, particularly for older, "seasoned" managers who may have had to adopt the mindsets of the ingrained *adversarial* and *transactional* models of business. [14]

High performance organizations that sustain their advantage over the long term place great value on their people and project teams. In particular, they are always pushing the envelope with new ways to work together to produce more value for their customers, their company, and their alliance partners, which requires:

- *Trust:* the essential behavioral foundation of all collaborative enterprise. Without trust, collaborative strategies, collaborative innovation, and collaborative execution (teamwork) is difficult, if not impossible. [15]
- *Collaborative Innovation:* the source code and cornerstone for all companies that exist in highly competitive environments where the onslaught of continuous improvement must prevail. Collaborative Innovation enables companies to be regenerative – to transcend their past and reinvent their futures. Collaboration unleashes the collective creative potential of people on the project.
- *Teamwork*: the coordinated effort through which high performance organizations deliver value. Without teamwork, value delivery can only be *transactional* at best. [16]

Trust Reduces Risk

Collaboration is both a risk mitigator and reward enhancer, as one senior executive[17] explains:

> *Sharing risk and creating value together helps build trust. When solutions are created collaboratively, it lowers our risk. We cannot be caught in a blame game, that just increases the risks. We need to work as a team in the supply chain; a team in the development phase, and a team in the project rollout – we work like a network. That helps them recruit and retain a highly skilled labour force, which helps reduce our exposure to risks. If we can find partners for*

[13] See Lynch, *Alliance Best Practices Workbook* and Alliance Best Practices at www.Strategic-Alliance.org

[14] Cultural change is not necessarily as difficult as it is often made out to be. If senior leadership makes trust, teamwork, and innovation the three "central organizing principles" of the new culture, and then aligns performance measures and rewards systems to support these principles, then the cultural shift can often be successfully attained in as little as several months.

[15] We've developed highly effective trust architectures that embrace the interpersonal roots of human behavior, and the operational and economic issues that support, sustain, and rebuild trust.

[16] Teamwork isn't just an internal function; it's just as important externally with suppliers, delivery partners, and customers; External collaborative teams are called "strategic alliances," providing coordination, cross-boundary problem-solving, & fresh ideas.

[17] Interview with Devon Energy's Steve Bass, November 2014, cited in Jergeas & Lynch, Ibid

> *the long-term journey, we can create something special. We can manage risk together, share learnings, knowledge and observations of what's going on in the marketplace. That can yield a truly rewarding relationship.*

While the power of trust is an imperative for collaboratively adding or creating value between supply chain partners, another important aspect of business relationships is driven by the *duration* of the relationship; it is *predictability*. Even if the parties do not fully trust each other, they can exchange and even add value if their actions are predictable so that they take the appropriate precautions when dealing with each other. While such relationships are not ideal, they are sometimes necessary.

Why We are Stuck in Adversarial Relationships

With the advantages of the collaborative, value maximizing strategic relationships being so evident, why does the business world seem so stuck? so difficult to shift? so rigid? often bent on value destruction?

The nature of competition pits companies against each other and the nature of capitalism requires a return on owner's investments (such as stock market, return on private investment, risk/reward tradeoffs). This gravitates toward an underlying reward system that does not reinforce sharing value across supply/value chains, but rather incents grabbing as much value as you can. Members of the supply chain are often in different industries and the value they represent to their investors is often in the context of individual industries and the individual company results relative to competitors – not in terms of a holistic supply chain. You can't buy stock in a supply chain, only in a company. In fact it is hard to even measure the value generated across a supply chain's contributing companies.

This reward system creates a value appropriation approach in the supply chain driven by four factors:

- Product – not every component of a product is a source/contributor of high value-added, thus player in the chain does not inherently get an equitable share of the value. More importantly, value (in each customer's eyes along the chain) migrates over time – would you be happy with the same cell phone you used in 2005? NO WAY!! Thus allocation of value is dynamically changing.
- Markets – the individual markets for each component (supply/demand) leads to different value levels over time. These market forces are the underlying rationale for the power of each member of the chain and power can and does drive how much value each player can extract.
- Competition within the chain – the chain's total value is not visible across the chain so each firm looks to make sure they get their share of the visible value, not some theoretical value sharing proposition.
- People – Company decisions are made by people and not all people get along or see the whole picture. When people/companies do not get along or trust each other, it is easy to justify grabbing as much value as you can in the short term when you have the chance.[18] Further, people are driven by their belief systems – if you believe in pitting value chain members against each other, then that's what you will do.[19]

This value grab mentality (evident in low-transparency interactions where engagement is distrustful) is also logical and reinforced by the nature of capitalism and investment returns – companies are

[18]Just as there has been no "value architecture," so has there has been no "trust architecture." Having an "architecture" enables people to have a common framework through which to understand, Trust Architecture and an understanding of Human Behavior is essential to being able to make this determination accurately. Knowing who to trust, who is not trustworthy, and what kind of leadership will result in what type of behavior is an essential element of Value Maximization. (See R.P. Lynch; "Culture as a Forcefield" and other writings/workshops.) Further, (that's why I spent several years designing this and why it's so powerful). With no "architecture" there is no common language, common systems, common methods, common strategies that produce predictable results. The combination of the trust architecture and the value architecture produce a synergistic, "force multiplier" effect.

[19] A tragic example of this mentality occurred in 1998 when Daimler took control of Chrysler, that had spent the prior six years instituting an elegant and profitable collaborative supply chain strategy that produced billions of dollars in profit. Immediately upon taking control of Chrysler, Daimler that did not believe in collaborative systems, disassembled the entire structure, profits plummeted, and within a decade had plunged into bankruptcy.

competing against competitors but also against suppliers and customers for their margins and share of the pie – sometimes even when the pie grows.

Why Companies Choose to Engage in Value Depreciation

To gain a deeper understanding of the resistance to value maximization, an exploration of why companies actually choose to engage in value depreciation may prove enlightening. While the more positive (Value Addition and Creation), and self-interest (Value Transaction and Protection) can be relatively obvious descriptions, Value Depreciation deserves more discussion because it raises the question, "Why would any company decrease its value on purpose?" If it were obvious that these activities reduced the level of value nobody would ever do them.

The reasons companies use this part of the pathway are three fold:

1. Use of power, particularly in markets with multiple suppliers or customers, leads to a quick increase in value. The longer term implications of such moves are often hard to foresee since commerce is a very complex environment that is constantly adjusting to market realities. For example, in the 1980's when GM (Lopez) cut suppliers and saved enormous amounts of money it looked like a major increase in value for the company. It took years for the value depreciation caused by companies leaving the business (changing the power equation), cutting corners (quality and service inferiority relative to GM competitors), or selectively withholding innovations from GM/providing innovations to GM competitors was visible in business results. These latent effects are often hard to predict.
2. The reward systems in business (see Purpose of Business comments), particularly the fact that competition, importance of the supplier to product design, competition within the chain over margins and supply/demand shifts in the markets that also shift the power structure. Again short term value looks positive but longer term it doesn't work out that way.
3. People – Sometimes people make decisions for personal reasons and company decisions are made by people. Decisions that reduce overall value can be made because the people (and companies) involved do not like each other, have a negative history with each other, don't trust each other or have a short term conflict that causes short term thinking -- which can produce totally irrational behavior (see Figure 5).

While the last reason places personal needs ahead of business value, the other two are important to consider. Short term value

National Hockey League Lockout – 2004-05 Season

Example of Value Depreciation

In 2004 the owners and the players of the National Hockey League locked horns in a labour dispute, resulting in the cancellation of very game for the entire season.

The owners claimed they had collectively lost over a quarter billion dollars in the previous season, and several had declared bankruptcy. The players wanted higher salaries through competitive bidding, and did not trust the owners when a report in Forbes magazine claimed they had inflated their losses by 50%.

Negotiations became cataclysmic, resulting in the cancellation of what would have been the NHL's 88th season. Revenues from 20 million paying fans and lucrative TV deals were lost, resulting in $2 billion in lost revenue for the owners, and over a $1 billion in lost salaries for the players – clearly a lose-lose-lose arrangement for the owners, players, and fans.

Value in the brand had been severely depreciated.

Figure 5: Value Depreciation and the Mythology of Rational Self-Interest

improvement can sow the seeds of long term value reduction. It is important to spend time trying to anticipate possible future scenario implications of these decisions to determine if using these approaches will reduce the amount of value loss – e.g. working collaboratively only to discover that the other side was not can lead to a major loss of value. Matching the approach of the other party is often the best way to operate at this end of the value stairway.

In effect, finding the truly collaborative and long term (not short term) value proposition is not necessarily the instinctual approach. That part is why value maximization is not something everyone does naturally – otherwise everyone would be doing it already. It requires insight, an aligned team, and very strong leadership, particularly within the power-players in the value chain.

However, having a new "architecture" – a new paradigm -- that lays out the objectives, methods, best practices, and real benefits of high trust cultures can shift people's attitudes and actions.[20]

[20]Our team created a Supply Chain Simulation in Alberta that replicates a real-time buyer-seller process. The advantages of a high-trust environment are readily apparent as the fulfillment rates are twice as high and the costs diminish by more than 25% comparing high-trust to poor trust interactions.

5. Measuring & Managing Value

Strategic Value Metrics

It's normal and appropriate for a corporation ultimately to translate all metrics into financial terms, which enables investors to compare companies side by side and to link performance to profitability.

It's just as important to ensure metrics are attuned to Value Maximization: increasing revenues, ensuring competitive advantage, deploying strategic assets and precious resources in the most impactful way, and ensuring long term sustainability.

Integrating Metrics for Evaluation

Every company and every in every industry has its preferred metrics system. The key elements of Strategic Value Metrics can be integrated into standard metrics analysis, such as:

- EVA (Economic Value Added),
- TCO (Total Cost of Ownership),
- DCF (Discounted Cash Flow),
- TVO (Total Value Opportunity),
- ROV (Real Value Options),
- DTA (Decision Tree Analysis)

and other scorecards to:

- test if there is divergence or convergence between the measurement systems,
- determine if the lack of *leading* indicators of success is producing poor competitive advantage.

Leading versus Lagging Indicators

Most financial indicators -- such as Profit, Revenue, Return, etc. – are inherently *lagging* indicators that demonstrate what happened in the *past*. In a fast moving, rapidly changing world, management by strictly by lagging indicators is risky at best and foolish at worst.

More appropriate is a system that targets key *leading* indicators that have the deepest impact on traditional *lagging* financial metrics, while at the same time maximizing strategic and operational value.

Strategic Value Metrics assess five critical metrics[21] impacting Value Maximization and advantage:

Leading Indicators

- Market Impact (Revenue Advantage)
- Competitive Advantage (Strategic Advantage)
- Organizational Effectiveness (Productivity Advantage)
- Innovative Capacity (Evolutionary Advantage)

Lagging Indicator

- Financial Gain/Return[22] (Security Advantage)

In a fast-moving world, leading indicators of success are far more important than lagging indicators.

By targeting key value drivers, key factors for success, and key leverage points for impact, each of these five Value Metrics work synergistically to reinforce Value Maximization. This yields a "Strategic Return On Investment (STROI)." In this way, the Value Chain seeks key strategic and operational benefits, and can then measure these returns against their "investment," which can include time, people, technology, and money.

[21] The details of the five critical impact metrics are extensive and will be covered in a future White Paper.

[22] Notice that "Financial Return" is only one of the five dimensions. Because the primary purpose of Value Maximization is also *strategic*, its rewards must be more than financial. Financial gain is not just a result of strategy, but also a measure of the combined strategic and operational success of the other four dimensions.

Strategic Cost ➔ Value Metrics

All businesses must carefully manage costs, else they spiral out of control. Traditional external cost management is done with brutal simplicity: send an edict telling all vendors they must lower the costs X% - either comply or lose our business. These edicts ripple up and down the tiers of the value chain, wreaking havoc along the way. Usually quality and fulfillment suffer; often suppliers simply exit the industry.[23] The cause of the problem is the lack of a clear Value Maximization system and strategy that enables precision cost cutting while aiming at creating more value simultaneously.

The objective of Strategic Cost➔Value Management[24] (SC-VM) is to focus on getting costs down while creating more value and improve strategic competitiveness; it's a disciple that considers four factors:

- Long Term Competitive Advantage for entire Value Chain (Strategic Battle of Value Chains)
- Value Driver Analysis to determine how to Increase Value
- Cost Driver Analysis to understand Root Causes of Costs while Reducing Non-Value Added Work
- Ensuring Products are Competitive both economically and functionally now and into the future

These three phases are characterized in the Value Iceberg (see Figure 6), diving progressively deeper into

Figure 6: Value Iceberg

[23] Prior to the recession of 2008, years of the cost-cutting edicts from Detroit's Big Three was taking a heavy toll; 500 suppliers a year were either exiting the industry or going belly-up. When the recovery happens, the value chain is so bruised and battered that it takes years to rebuild what has been destroyed. Profits that could have been gained on the upswing can never materialize.
[24] Shank, John K & Govindarajan, Vijay;Strategic Cost Management, the New Tool for Competitive Advantage, Free Press, 1993. . (We've added the word "value" to the process to reflect the shift from cost to value-based objectives of strategic value chains).

the *Cost* ➔ *Value Shift*.

To be effective, strong expectations must be set for continued improvement, so every member of the value chain understands new value creation is expected (not just desired) to remain competitive relative to their direct competitors and to logical substitutions for their product. This is a critical factor because it combats complacency and keeps the members of the value chain sharp in terms of their operations and their innovation (both process and product).

Below we outline the short term Best Practices to commence the *Cost* ➔*Value Shift*, with the understanding it is actually a long term evolutionary effort that never ends.

Analyzing the Cost ➔ Value Drivers

What separates traditional cost management from Strategic Cost➔Value Management are four factors which must be carefully integrated into the cost analysis:

1. Value Drivers – Cut the Fat, not the Muscle
2. Value Chain Advantage – Strategic Battle of Value Chains Drives Total Cost of Ownership
3. Strategic Value Metrics – Cost Cutting should have Positive Impact on Critical Metrics of Success
4. Cost-Value Sharing – Working together across the Value Chain to share cost advantage

1. Value Drivers – Cut the Fat, Not the Meat

It's essential to understand what is "driving" the value paradigm before cutting cost. Value drivers can range from customer needs (which should be identified clearly), costs, delivery, service, reliability, continuous improvement, training, etc. (see side bar) If value drivers are not clearly identified, then it becomes all too easy to "cut the muscle, not the fat." Once value drivers are identified, only then should cost drivers be evaluated to determine what the impact will be on value. Cost drivers can include NVA (Non-Value Added work), VD (Value Destroyers such as adversary relations), cost-volume relationships, labour (poor training, labour contracts, etc), structural costs (scale, location, etc.), engineering (design, materials, etc.), production (quality, flow, constraints, etc.), technology (availability, capacity, integration, etc.), experience (embedded know-how, wisdom, competence, etc.), and complexity (compounding complexity, sequencing, inter-dependence, breakdowns at interfaces, etc.)

Examples of Value Drivers

- Imagination & Innovation
- Collaboration, Communications, Trust, Teamwork
- Eliminated Non Value Added Work
- Safety & Security
- Reliability, Accuracy, Ease of Use
- Low Cost (Component or TCO?)
- 100 % Quality, 100% on Time Delivery
- Integration with other functions
- Advanced Technology
- Convenient, Friendly Business Model & Warranty

2. Value Chain Advantage – End to End Impact

Because Value Maximization embraces an end-to-end (E2E) value chain strategy for value creation, capture, and delivery, cost cutting efforts must encompass other value partners both upstream and downstream to ensure that cost cutting increases (or is neutral to) competitive advantage. Ultimately, the Battle of Value Chains prevails because the end-use customers pay for all the profit

margins along the value chain.[25] Effective use of the value chain can significantly improve both cost leadership and product differentiation, building brand loyalty (trust), improved product design, more effective use/integration of advanced technology, better delivery, and improved service. Significant profit gains can be made had by improvement in the nature of the linkages and process flows *between* suppliers and customers, as well as internal chains in companies (i.e. cross functional integration).

Efforts that act independently of value chain partners may have adverse impact on other parts of the value chain. For example, when General Motors unilaterally sliced and diced supplier costs with a Draconian sword, quality plummeted, warranty costs skyrocketed, order fulfillment became sporadic with backorders slowing down production, and innovation flowed to GM's competitors. When examining value chain costs, Lean Management, Total Cost of Ownership, Target Costing, and Value Engineering frameworks are highly effective.

Key Questions to ensure sustainable competitive advantage in Cost Cutting

1. Can we reduce costs in this activity, while holding value (revenues) constant?
2. Can we increase value (revenues) in this activity, while holding costs constant?
3. Can we reduce assets in this activity, while holding costs and revenues constant?
4. Can we reconfigure the value chain to reduce costs and increase flow of value?

Source: Shrank & Govbindarajan, Ibid, p 60-61

Each firm must be able to capture its fair share of the value that is created. Too often the value flows to those with the most value, and if a supply chain member cannot keep some of the value, they will cease to exist long term. While having a customer or supplier share value is one way to do this, it is also important for each company in the value chain to manage its business so that it maintains a reasonable margin (and so must have enough cost control to make a profit while competitively pricing its product so its customer can also profitably operate as well).

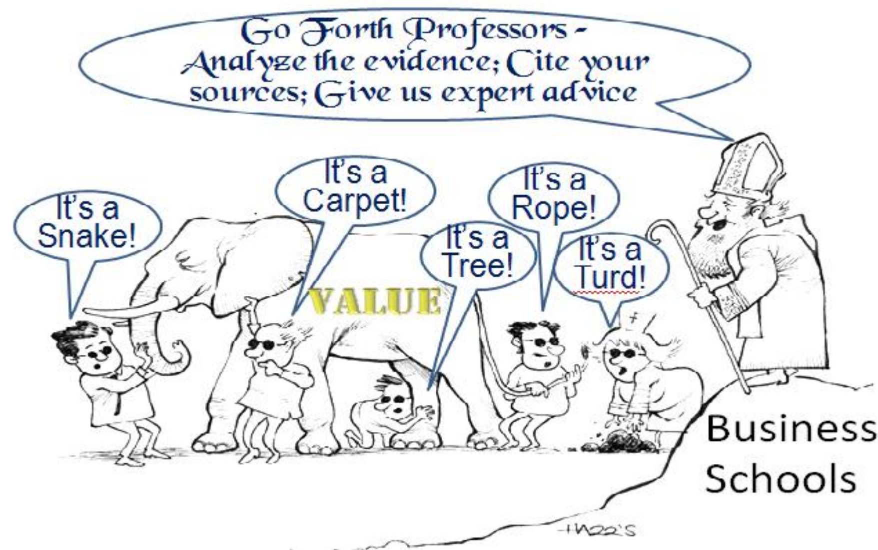
3.Strategic Value Metrics – Measuring Cost and Value

Metrics will drive behavior because they represent how a business and its value chain measure success. Before cost-cutting, the Strategic Value Metrics (Strategic Return on Investment) should be revisited by key members of the value chain to reassess the value metrics and interdependencies in light of new competitive requirements. Key metrics attached to four Leading Indictors -- Market Impact, Competitive Advantage, Organizational Effectiveness, and Innovative Capacity – should be closely examined, along with their cost implications. Then a comparison of value metrics, cost drivers, and profit variance analysis will enable a value chain team to determine what costs are necessary to create/retain value, what costs are superfluous, and what targets should receive priority attention. This will cause cost cutting to be done with a surgical knife while keeping the patient alive, rather than with the radical blunt instrument impact by sending an edict for a 20% cost decrease.

[25] Shrank, John K. & Govindarajan, Vijay; Strategic Cost Management, Free Press, 1992 p 51

4. *Cost-Value Sharing – Working Together to Create Mutual Value*
   One of the deep principles in Value Maximization is the sharing of benefit for stakeholders in the value chain, including customers, suppliers, investors, employees, management, and the communities that provide the human resources and infrastructure to support the business. Value sharing also means risk and reward sharing in which each member of the chain bears not only risk, and responsibility, but is also rewarded for their efforts to produce value and competitive advantage. For example, auto giants like Toyota and Honda are extremely meticulous in how they manage their relationships with suppliers who provide 80% of the parts used in new car manufacture. Both Japanese auto makers have their own version of a Value Maximization strategy, ensuring lean value chains, collaborative relationships, high levels of trust and teamwork, and continuous improvement and innovation. Each takes extra steps to ensure their suppliers are reasonably profitable; no supplier can gouge, for it is essential for every member of the chain to prosper in order to have sufficient money to invest in future capabilities. But in tight economic times, each member of the chain is expected to tighten their belts to remain competitive.

Value Maximization is the "missing link" in business, the "elephant in the room" no one has wanted to tackle.



This paper has aimed to address the "elephant" as a holistic system, see its core elements, and propose a way forward for the future of business in the context of the value chains that frame its competitive environment and the strategic alliances needed generate a sustainable future.

The following section outlines some of the key points that must be addressed by leaders to shift into Value Maximization.

Leadership: How to Implement the Shift

Here are 6 steps to put a Value Maximization System into place[26]: (A future White Paper will elaborate)

Step 1: Compelling Rationale

- Sense of Urgency or Need --Awareness of the Problem & Opportunity
- Identify crises, potential crises, or major opportunities
- Examine market and competitive realities
- Develop Powerful Messaging

Step 2: Build a United Leadership Team

- Strong Voices Aligned in their Call to Action
- Use the Influence of Authority
- Willingness to change voiced by those "in the know"

Step 3: Design a Clear Vision, Value & Strategic Pathway

- Outline the Vision, Value Proposition, and Strategic Pathway
- Assign Operational Goals, Actions, & Responsibilities
- Examine Financial Modeling
- Build Internal and Value Chain Capabilities & Train
- Over-communicate the message

Step 4: Create Rapid Results

- Empower Teams to Act -- Create Evidence & Belief
- Gain Traction with Quick Wins – Launch Pilot Projects
- Manage Risk by focusing on Value Added, Collaboration, Teamwork, Trust, and Alliances
- Capture the Learning, Distinguish the Old Way from the New Way
- Communicate the Results
- Redouble the Effort

Step 5: Reduce the Risk & Resistance to Change

- Encourage Risk Taking
- Remove Obstacles to Change
- Sideline the Stubbornly Resistant
- Celebrate and Promote Victories
- Recognize and reward employees involved in the improvements

Step 6: ReAlign the Organization

- Hiring, promoting, and developing employees who can implement the vision
- Reinvigorating the process with new projects, themes, and change agents
- Improve Career Paths for High Performers
- Realign Metrics & Rewards to support the new system

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[26] Portions attributed to Kotter, John, *Leading Change, Why Transformations Fail*, HBR, 1996

Appendix: Criteria for a Systems Design Architecture

Twelve Standards For Best Practice Alliance, Value Maximization & Trust Architecture

During our assessment of Systems, Integration, and Frameworks for Best Processes and Best Practices, we apply stringent standards to ensure the quality of the outcome.

1) **Applicable:** *Is there both Strategic and Operational integrity & advantage to be gained? Is there a clear "flow" of the practices in an orderly or rational sequence? Does the principle or practice have applicability to nearly all situations, regardless of industry or culture?*
2) **Actionable:** *Will the framework principle truly work in practice, or is it just nice theory? Are the Actions clear, concise, and linked to the practice, principle, or process? Is it easy to communicate, especially across boundaries?*
3) **Understandable:** *Can this framework, principle or process be simply communicated to those involved?*
4) **Verifiable:** *Can we clearly observe the changes when the principle or practice is put into place?*
5) **Measurable:** *Is there a method of measuring this principle's/process' effectiveness in action?*
6) **Controllable:** *Will the principle enable more effective control of direction, intensity, speed, etc of the alliance?*
7) **Diagnosable:** *Is it clear what "not to do?" When there is a problem, can we see the problem clearly, do we have a way to recognize the misapplication of the principle/process?*
8) **Prescribable:** *If an element is missing, can the principle/process be injected into the system to cause a cure?*
9) **Replicable:** *Can we recreate a positive result, time and again?*
10) **Trainable:** *Can operational managers successfully acquire the skills and knowledge required for implementation?*
11) **Valuable:** *Is the principle/process really essential, or merely a superfluous nicety?*
12) **Predictable:** *Can we foresee, in advance, the positive or negative results? Are there 'preconditions' for success needed in advance of a program launch?"*