

From Contact to Contract

Achieving Operational Excellence in Demand Chains

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Introduction

While the term “demand chain” isn’t new, it hasn’t had the kind of traction nor level of success when compared to the supply chain transformation.

Everyone recognizes the importance of optimally balancing demand and supply for profitability. But why is it that when it comes to Operational Excellence, the supply side has made more progress than the demand-side? In other words, why isn’t management equally fanatic and disciplined about reducing the Cost of Customer Acquisition as they have been about reducing the Cost of Goods Sold?

If that is indeed the case, then the purpose of this paper is to start a conversation about change on the demand side of the equation. Much like the success we’ve seen in supply chains, we need integrative thinking and action if we are to bring about the same degree of Operational Excellence in Demand Chains.

We first begin by exploring the following questions:

- > **Why take a Demand Chain perspective?**

(Because there is significant value creation potential, e.g. improved lead quality, lower costs, faster time-to-close, etc.)

- > **Who needs to embrace this concept?**

(Primarily, the Sales, Marketing, and Channels functions.)

Once the value of an integrated Demand Chain perspective is understood, we delve into the various considerations in bringing this discipline into the organization:

- > **How should you bring about change?**

(What are the critical change dimensions needed to unlock the full value potential?)

- > **What are the critical change dimensions?**

(Put in the context of AcmeSoft’s business.)

What constitutes the “Demand Chain”?

Much like how “Supply Chain” represented a logical grouping of the Procurement, Manufacturing, and Logistics functions, the Demand Chain is also a logical grouping of the functions involved in creating and managing demand.

When looking at a company’s financial statements, we see that these functional groupings contribute to the Top three cost centers in an income statement. These three cost centers collectively represent the “value-creation engine” of any business:

- Sales & Marketing Expenses = Cost of customer acquisition (Demand Chain)
- Operations Expenses = Cost of goods/services sold (Supply Chain)
- R&D Expenses = Cost of product innovation (Design Chain)

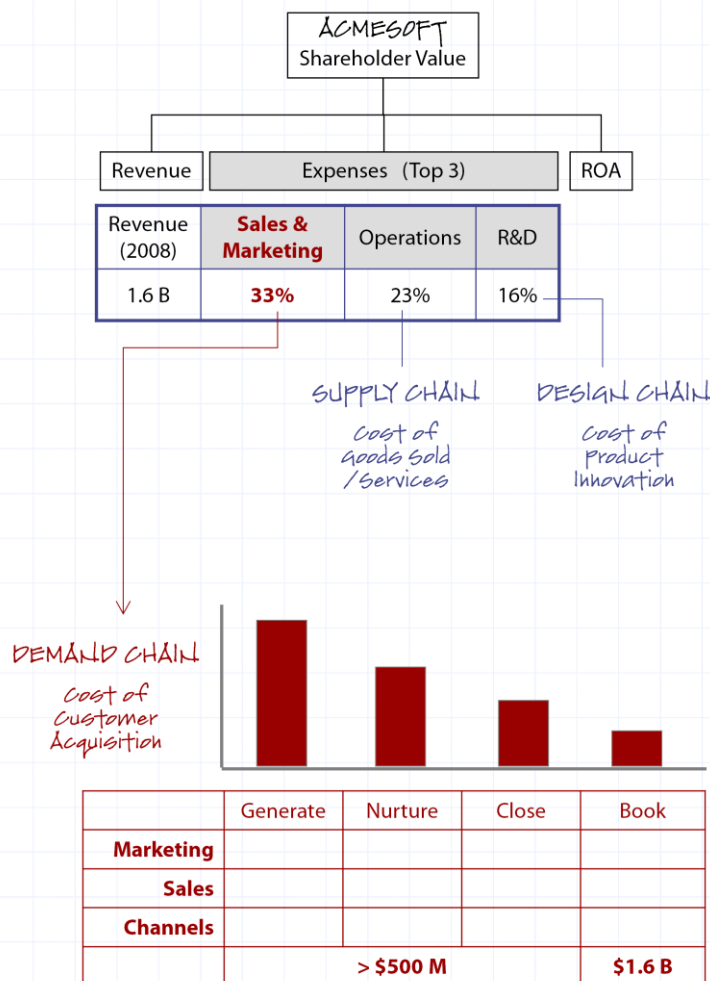
On the left, we show this breakdown for a hypothetical company called AcmeSoft.

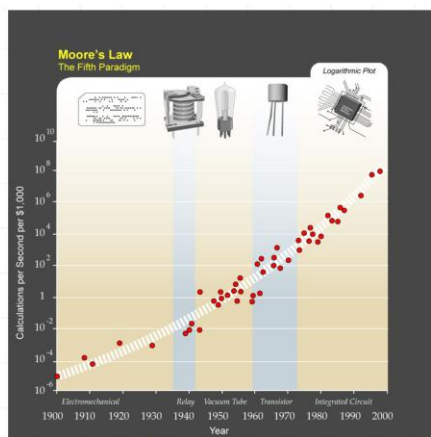
In 2008, the total cost of its demand-related functions was 33%, or over \$500M. For many reasons, the level of visibility or transparency into the Cost of Customer Acquisition is far more limited (and buried within SG&A) when compared to what one typically sees on the supply side when drilling down into the Cost of Goods Sold. So one of the goals of Demand Chain is to bring about greater visibility into the Cost of Customer Acquisition.

But why, specifically, is the “chain” perspective useful?

- A chain illustrates the concept of interdependency, which is critical to understanding cause-and-effect relationships. This helps tear down the walls between the functional silos in a value chain to be able to view and manage an integrated end-to-end, i.e., contact-to-contract process.
- A chain is only as strong as its weakest link. In other words, the weakest link is the primary constraint. And systems theory proves that improving the primary constraint results in an improvement across the whole system.

In other words, a 1% improvement on the primary constraint in AcmeSoft’s Demand Chain would translate to \$5M in value. (That’s just cost efficiencies and not considering added revenue contribution through sales effectiveness.)





50 years of Design Chain Progress:
Moore's Law



20 years of Supply Chain Progress:
Inventory-to-Sales Ratio

The Demand Chain is part of the Operational Excellence journey

Bringing Operational Excellence to the Demand Chain is a journey well worth pursuing. However, achieving and sustaining it requires discipline and a long-term perspective in order to continually push the performance frontier. This is exactly how the Design Chain and the Supply Chain disciplines continue to drive successive cycles of innovation and efficiency. To accelerate the transformation, AcmeSoft should consider:

1. Reusing/repurposing what's already been proven:

Design Chain: For the past 50 years, we have applied principles like Moore's Law to understand the exponential growth curves of technology-enabled innovations. The very success of companies like Whirlpool, Apple and IDEO are based on these core principles that have become the cornerstone of today's design chain thinking. Many key principles like stage-gate decision making, portfolio optimization, and transition planning are readily applicable to AcmeSoft's Demand Chain processes.

Supply Chain: For the past 30 years, inventory-to-sales ratios have been steadily declining (except during recessions) because we have applied scientific thinking to the supply chain. Similarly, the success of companies like Dell and Wal-Mart were built on these core principles. And key Supply Chain principles like collaborative forecasting, constraint management, yield optimization, and promotions planning have a lot to offer in improving AcmeSoft's Demand Chain.

2. Building and nurturing a continuous improvement culture:

Lean Thinking: Continuous improvement methodologies like Lean have much to offer, including its famous "seven types of waste" in supply chain processes. For example, the contact-to-contract cycle for complex sales cycles often takes many weeks or months, but only a fraction of this time can be considered truly value-added. Another example of waste comes from the "spray-and-pray" approaches used by marketing that results in spamming customers and prospects with information. Bringing Operational Excellence to Demand Chains requires an ongoing effort or continuous improvement culture that steadily squeezes out inefficiencies and compresses the contact-to-contract cycle.

What makes managing the Demand Chain complex?

To understand this, let's put it into the context of AcmeSoft, a global provider of technology solutions with 1.6 billion in software and services revenues in 2008. Its demand profile is quite complex and consists of at least four major dimensions:

CUSTOMER: AcmeSoft's technology addresses a broad and basic computing need, where their customers range from the largest enterprises in the world to individual consumers. Today, these customers are grouped into five major segments: Enterprise, Government, Mid-Market, SMB, and Consumer.

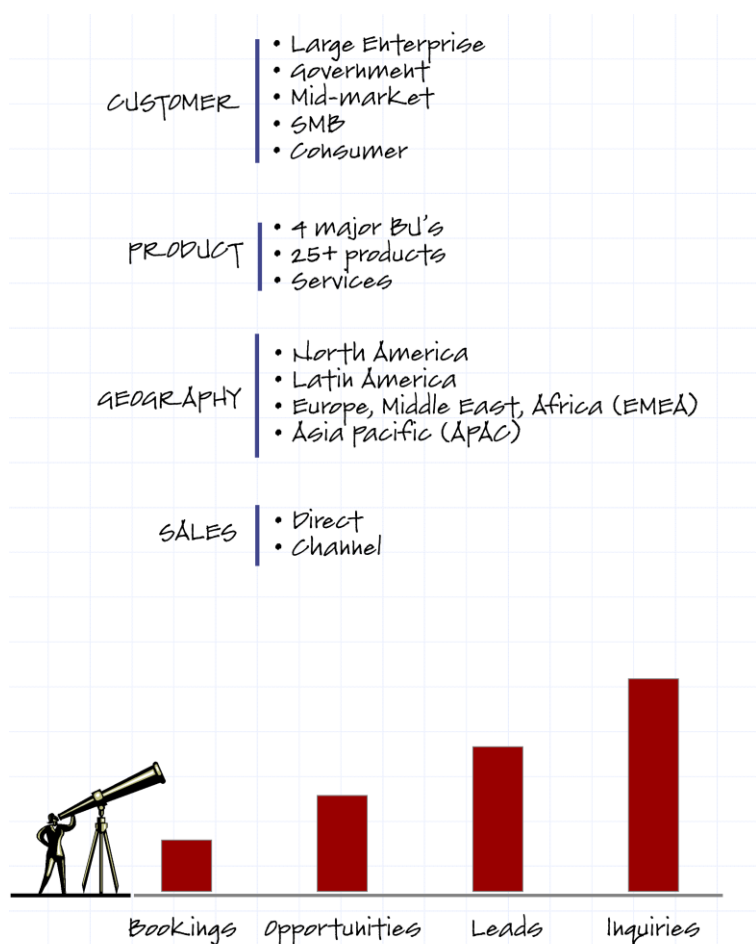
PRODUCT: While the company's product line started out simple via organic R&D, like many technology companies today, it has aggressively expanded its product portfolio through acquisitions. Today, it has over 25 products grouped into four major product business units. These products are delivered as either on-premise or on-demand offerings, including a range of services to support successful adoption. Some of these products are quite mature in their lifecycle where they have become commodities. But the company continues to regularly introduce innovative products that capture new markets and advance its position as a market leader.

GEOGRAPHY: The company maintains a global presence in all major markets and is managed along four major geographies: North America, Latin America, EMEA, and APAC. Each region has its unique characteristics that influence the adoption of AcmeSoft's products.

SALES: The company's sales strategy uses both direct sales as well as channels where the mix of direct vs. channels is different based on customer segment and/or geography.

A couple of key takeaways (and larger topics by themselves) here:

1. There is more than one demand chain – and in the case of AcmeSoft there are at least five major demand chains and many more as we account for each dimension.
2. When faced with complexity, the natural instinct is to simplify (and Sales and Marketing cultures are prone to oversimplification). The market leaders are those who know how to exploit complexity to their advantage – and recognizing this aspect of the Demand Chain challenge is ultimately a leadership test.



Demand Chain thinking takes a lifecycle perspective

The Performance Management frameworks for Supply Chain and Design Chain are relatively mature because there was a general level of consensus on what the scope of the end-to-end processes were.

Think about it: If our objective is to improve a system, then we must first ask ourselves: Am I measuring the whole system? Or just part of the system? In other words, we have to agree upon a lifecycle definition first (and in this case, we think of the Demand Chain lifecycle in terms of “first contact-to-contract signing”).

Now, when we look at the lifecycles of the Top three cost centers, we notice that their performance metrics start to map to three basic measures: Cost, Quality, and Time. For example:

	Cost	Quality	Time
Supply Chain	Total Landed Cost	Perfect Order Metrics	Order-to-Cash
Design Chain	Lifecycle Margin	Lifetime Defects	Time-to-Market
Demand Chain	Cost of Sale	Conversion/Yield	Contact-to-Contract

Of the three “chains,” Supply Chain has the most mature hierarchy of metrics since it got a head start because the technology to capture and track the entire order lifecycle matured in the 90s. What drove Supply Chain was the ability to answer the single-most important question to the customer: “Where is my order?”

Similarly, the Design Chain (via Product Lifecycle Management) matured in the last 10 years, and adoption was driven by time-to-market, innovation, regulatory pressures and several high profile product recalls (lead in toys, tires, spinach, etc.)

In contrast, the first generation of CRM was only half the journey. Despite the heavy adoption of Sales Force Automation, it only captured part of the contact-to-contract lifecycle (from Opportunity-to-Close), and the technology for managing much of the upstream processes that Marketing dealt with was not ready at that time. But in the past two to three years, we have seen a number of innovations in technology, such that this second wave has dramatically improved our ability to enrich, automate, and measure more of the contact-to-contract lifecycle. With technology closing the gap, it's now up to us to fix the process, policy, and people-related issues.

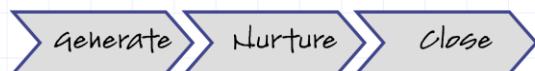
Supply Chain
Lifecycle = Order-to-Cash / Procure-to-Pay
Timeline: Days/Weeks/Months



Design Chain:
Lifecycle = Design-to-Dispose
Timeline: Weeks/Months/Years



Demand Chain:
Lifecycle = Contact-to-Contract
Timeline: Weeks/Months



The dimensions of Transformational Change: An example

In order to tackle a transformational change like Demand Chain, we must first understand what the change dimensions are, and how they must be considered in concert. Let's walk through a simple example of a pain point at AcmeSoft.

Challenge/Pain Point: Leads generated by Marketing campaigns are either not processed on time or remain unprocessed by Inside/Field Sales. Furthermore, leads created by a campaign for Product A may result in an opportunity for Product B, but Marketing fails to get credit since the promotion cost was allocated to Product A.

Now, if we think of leads as "inventory" and apply Quality Management and Inventory Management principles, we'd ask ourselves the following questions:

Process: Who ordered this inventory? Sales? Product Marketing? Channels? Why was it not consumed? Who is accountable for unused/obsolete inventory? Are there clearly defined quality control [acceptance] criteria from Sales? What happens to rejected inventory? Are they discarded or reworked? How/where are "reject reasons" captured? Can the surplus be offloaded to capacity in Channels?

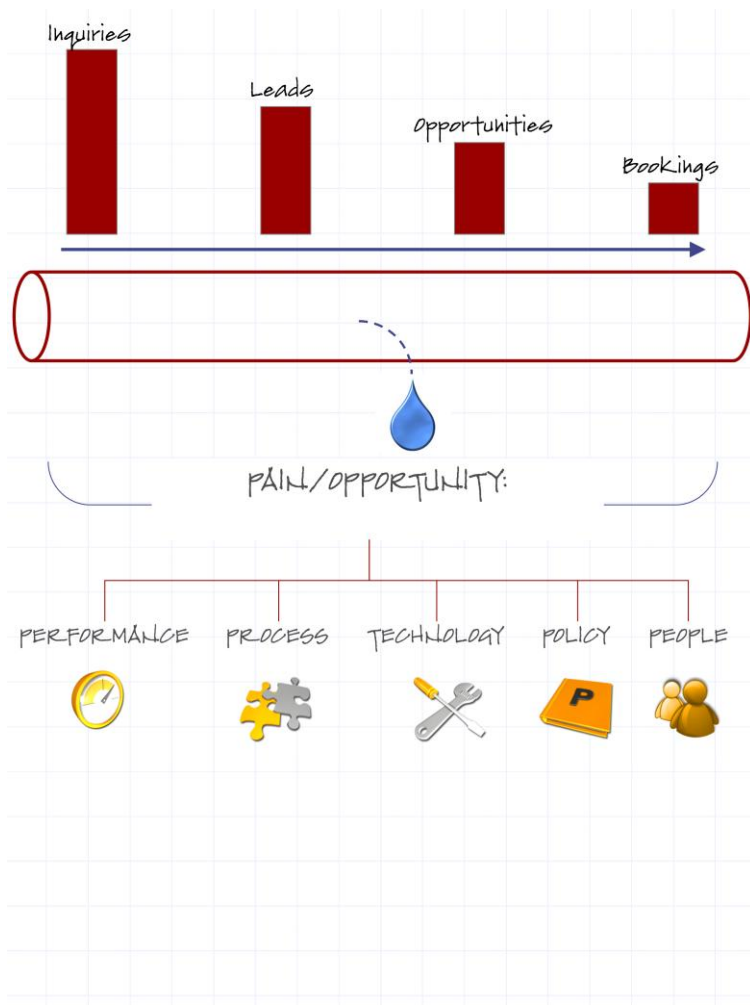
Policy: If Marketing is measured on [New Leads] inventory, then who owns the rework inventory [Nurturing process]? How do you "age" this inventory – before they are removed from the Demand Chain due to obsolescence?

People: Who owns the resources [Telemarketing] to perform the rework? Marketing? Inside Sales? Is this capacity treated as a fixed cost? Does an outsourced operation help treat this as a variable cost? Will outsourcing bring better inventory accountability?

Technology (Platform): How does the CRM system designate accepted vs. rejected inventory? Does it enforce the "chain of custody" by forcing the creation of opportunities from the existing leads inventory (and prevent the duplication of leads)?

Performance: What data is the system collecting to improve Lead Quality, Cost, and Time? Where and what are the constraints to the pipeline?

So here's the question: If we have been able to transform the Supply Chain to intelligently manage the inventory of our physical product, then what is preventing us from applying this discipline to managing the inventory of leads on the demand side?



PLATFORM: The major barriers have fallen...

In the last five years, the technology dimension has dramatically evolved to give us new ways to manage the Demand Chain. Today, a number of technologies have matured, enabling vendors to put together an integrated platform to help us better interact with prospects and track these transactions to give us an accurate picture of their contact-to-contract experience. The bottom line is this: Technology is no longer the constraint — people, processes, and policies are. Practically, any process change can be institutionalized by the technology available today.

Instead of delving into specific technologies, what is useful for those contemplating the Demand Chain journey is to step back and look at the convergence of key megatrends and the possibilities it offers. In particular, the following megatrends help underscore that we have arrived at an inflection point where early adopters stand to gain significant competitive advantage through the new generation of Demand Chain technologies.

Addressability + Mobility: These two trends have helped create the foundation. In Supply Chain, we are well on our way to tagging inventories and assets with the help of Auto ID technologies. And mobile technologies ensure that we can track the inventory and assets regardless of whether they are “at-rest” or “in-motion.” In the Demand Chain, it is much harder to “tag” people and their activities, but the challenge is less about technology and more about social norms and privacy issues.

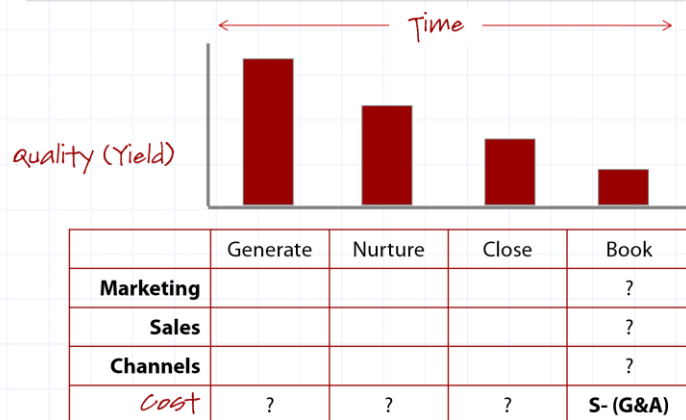
Social Media: This megatrend is about having real conversations with prospects, customers and partners. We are still figuring out how to make it work for us, but there is no denying that the technology combines the economics of “one-to-many” with the personalization benefits of “one-to-one.” Its applicability to demand forecasting and customer-driven design is just barely scratching the surface of its fullest potential.

BI/Analytics: We have more data than we know what to do with it. But to evolve from Reporting (which has been called “driving using the rear-view mirror”) to Predictive Analytics requires us to understand and model cause-and-effect relationships in the Demand Chain.



Figure A:

	Revenue	Expenses (Top 3)		
Peer Group	Revenue (2008)	SG&A	Cost of Revenue	R&D
AcmeSoft	1.6 B	44%	23%	16%
Company A Direct Competitor	6.1 B	44%	19%	14%
Company B Channel Master	36.1 B	27%	36%	14%
Company C ERP Leader	23.2 B	23%	20%	11%
Company D "Consumer Apps Leader"	4.2 B	24%	50%	32%



PERFORMANCE: Finding the right peer group

While it is clear that in AcmeSoft's case we can squeeze out 1-2 percentage points, is there a benchmark to gauge the maximum value potential in the Demand Chain?

The answer may not be simple, because it depends on the complexity of the demand profile. (See page 5.) To illustrate this, let's look at a sample peer group of AcmeSoft and their corresponding Demand Chain costs*:

If we benchmark against Company A, the **direct competitor**, then AcmeSoft Demand Chain costs are the same, leading one to conclude that the company is doing a good job of controlling its Sales & Marketing costs.

If we benchmark against Company B, the **channel master** who is the industry model of channel efficiency, we see there is significant room for improvement.

If we benchmark against Company C, the **enterprise apps leader**, who is the industry model for winning high-margin deals via a suite or platform strategy, then there is even further room for squeezing value out of the Demand Chain.

If we benchmark against Company D, a **consumer apps leader**, we see that there is a significant value gap in terms of Sales & Marketing costs here as well.

So who is the right peer group to benchmark against?

The answer is ALL of them, because in AcmeSoft's case there are actually five (5) separate Demand Chains each with its own peer group or benchmark.

In other words, it may make sense to use Company B as the benchmark for the SMB segment, Company C as the benchmark for the Enterprise segment, and Company D for the Consumer segment, etc. Without this level of granularity, AcmeSoft risks having a high level of cost distortion with an aggregate view of its Demand Chain.

Should AcmeSoft choose to pursue this path of deconstruction and analysis, then each unique Demand Chain would show a different distribution of Sales, Marketing, & Channel costs across the Generate, Nurture, and Close stages. And having an understanding of real costs will help ensure that AcmeSoft is making smart decisions that enable better "demand shaping" and responsiveness.

(* Ideally, we should be looking at Sales & Marketing cost only, without G&A.)

PERFORMANCE: Where is the constraint?

In Part I, we briefly discussed the importance of Constraint Management principles. In AcmeSoft's case, the fact that there are at least five unique Demand Chains to contend with makes it very challenging to identifying the constraint (and that's just looking at the highest level of customer segmentation).

On the left, we show a highly simplified view of a B2B Demand Chain with the three major value-added stages which address three major questions from the customer perspective.

The primary constraint in the contact-to-contract lifecycle for each Demand Chain may depend on a number of variables, including:

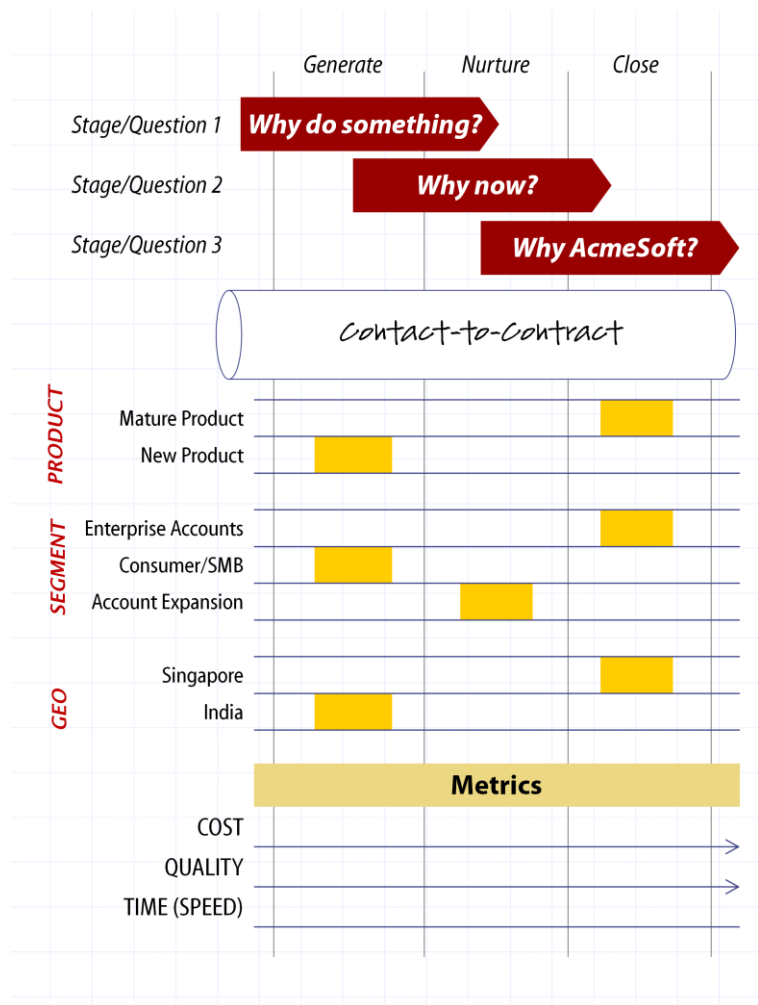
Product characteristics: For example, a mature product may require fewer resources to answer "why do something?/why now?" (Stages 1 and 2) but more effort to answer "why AcmeSoft?" (Stage 3) because the customer is likely to have more competing choices in a mature market. In contrast, a new product may require more effort early in the pipeline (Why do something/why now?) but closing may take less time because there is no competition and/or trust was already built during the early engagement and education phase.

Segment characteristics: For example, an enterprise deal may consume a lot of resources in Stage 3 because the sales process involves getting buy-in from multiple business units, given the delays in agreeing on a corporate IT standard. On the other hand, an SMB account may have a far simpler decision process (assuming one is dealing directly with the owner).

Geography/Market characteristics: For example, comparing South Korea's internet adoption rate of 77% to India's 7% may imply that one market may be ready for a "platform" message while the other prefers point solutions.

So we see that the "constraint" can vary a great deal, and the consequences of not having or using this intelligence results in "spray and pray" campaigns and suboptimal resource allocation decisions across the Demand Chain.

Furthermore, not accounting for such variables only adds to the distortion in the core performance metrics of Cost, Quality, and Time of the various Demand Chains, thus being counter-productive to the Operational Excellence goals.



POLICY: Creating optimal “go-to-market” strategies

Policy is an umbrella term that covers everything from strategy to execution tactics. In effect, they are the governing protocols or rules that guide intelligent decision making and consistent execution. (And all too often, bad policy leads to “politics.”)

Although AcmeSoft does have basic rules in place, these policies are not quite sophisticated enough for the desired revenue and margin visibility, especially considering that the company has one of the more complex Demand Chains in the industry.

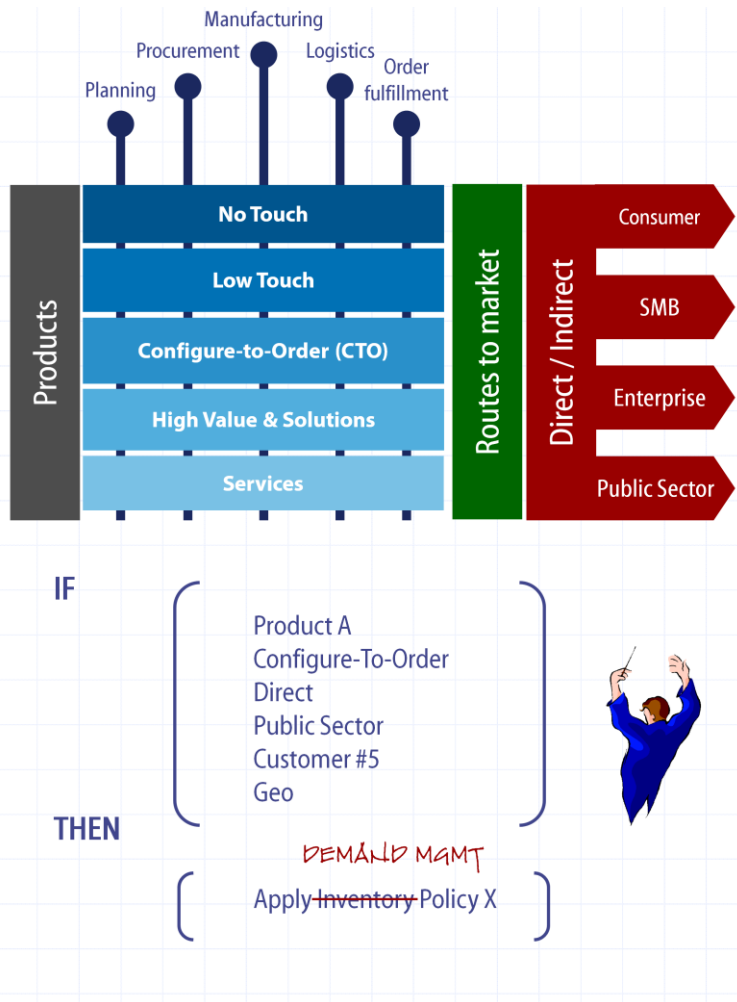
For an example of best-in-class policy management, let’s look at a company from AcmeSoft’s peer group and what they are doing in the Supply Chain.

The company depicted on the left is a leader in Inventory Management. With over \$50 billion in material spend, 700 suppliers, 119 logistics partners, and a mix of direct and indirect channels serving over a million customers, Inventory Management is a core competence at the heart of the company’s success. Like the example shown here, it employs very sophisticated logic to meet its customer service and profitability targets while providing visibility to many of its ecosystem partners.

Although AcmeSoft does not have the challenge of managing physical inventory, it needs to recognize that the opportunities, leads, and inquiries in its Demand Chain are in fact, “virtual inventory” and should be managed as such.

Once the leadership recognizes and accepts this premise, then the requisite analysis of its multiple Demand Chains and the design of the appropriate policies that govern the various go-to-market strategies will naturally follow. So similar to the five go-to-market strategies depicted here (No-Touch, CTO, etc.), AcmeSoft needs a core set of go-to-market strategies and corresponding policies that help orchestrate and control the underlying complexity of its multi-faceted business model.

(Note: As the Supply Chain and Design Chain disciplines continue to evolve, we are learning that the best way to institutionalize policy is through a “playbook” built on proven practices and continuous learning. This concept is prevalent in sales, and for AcmeSoft, it means extending this playbook concept upstream into Marketing and across into the Channels organization via a set of Demand Management policies that guide how to navigate the complexities of AcmeSoft’s Demand Chain.)



PROCESS: Modeling actual costs in the Demand Chain

By leveraging Lean/Six Sigma, Activity Based Costing principles, etc., we can use value stream mapping to understand the cost drivers of the contact-to-contract lifecycle. The value stream map or framework shown on the left is based on the same principles used by Manufacturing to determine the true cost of producing an item. Specifically:

(1) In Manufacturing, we have a Bill-of-Materials that lists all the components that make up an item. Similarly, in the Demand Chain, we have a “Bill-of-Experience” that lists all the different interactions that together constitute the customer experience as they move through the contact-to-contract lifecycle. Since interaction types are often grouped by expertise (Web, Telemarketing, etc.), they are no different than work centers from a costing perspective.

(2) In Manufacturing, the Routing captures the sequence of operations by which raw material is transformed into a finished product. Similarly, in the Demand Chain, each prospect goes through a sequence of interactions as it progressively moves through the major stages in the contact-to-contract lifecycle. The key difference (and challenge) between Manufacturing and the Demand Chain is that the routing sequence or “interaction path” is unique to each prospect.

(3) When we combine the Bill-of-Experience and the Interaction Path, we can now calculate the true cost of acquiring a particular customer, or any grouping of customers and prospects.

Once this basic framework has been flushed out and is in place, then we can build upon this foundation to add the Time dimension and the Quality (Yield/Conversion Rate) dimension to gain greater visibility into the true dynamics of the Demand Chain through the use of sophisticated models.

(A cautionary lesson on modeling from the Supply Chain experience: Modeling is both art and science – finding the right balance between abstraction and detail is an iterative exercise, and we should be careful not to let perfect become the enemy of the good. As someone put it best: “Not everything that counts can be counted and not everything that can be counted counts.”)

Bill-of- Materials -> “Bill-of-Experience”

Interaction Type	Target Cost / Interaction
Online/Web	
Onsite/In-Person	
Phone	
Print/Mail	
Print/Ads, etc.	

Routing -> Learning/Interaction path

Interaction Type	Generate	Nurture	Close
Online/Web	1	3	5
Onsite/In-Person		4	6
Phone	2		8
Print/Mail			9
Print/Ads, etc.			

[Bill-of-Experience] + [Interaction path]

Interaction Type	Frequency	Cost Per.	Total Cost
Online/Web	3	?	
Onsite/In-Person	2	?	
Phone	3	?	
Print/Mail	1	?	
Print/Ads, etc.	0	?	
True Cost of Customer Acquisition >>			?



PEOPLE: Creating a Demand Chain Center of Excellence (COE)

If we look at the poster children of the Supply/Design Chain transformations, one success factor they shared was the existence of a “Center of Excellence.” The COE isn’t a new organization but rather a virtual structure to facilitate communication, collaboration, and visibility across functional and organizational boundaries.

Some initial questions (and policy decisions) to consider:

What will be the mission/vision for the Demand Chain COE?

In the short term, its focus may be on tighter integration of the Sales, Marketing, and Channels functions and “move the performance needle” by 1-2% points each year in terms of Sales & Marketing costs.

Because the Demand Chain is the first “ring around the customer,” in the long run, the COE’s focus should be on Customer-Centricity (as depicted on the left). This means opening up participation to any function (inside and outside the four walls) that is interested because the goal of customer-centricity is to build an ecosystem that can sense-and-respond to changes in customer expectations (faster than the competition).

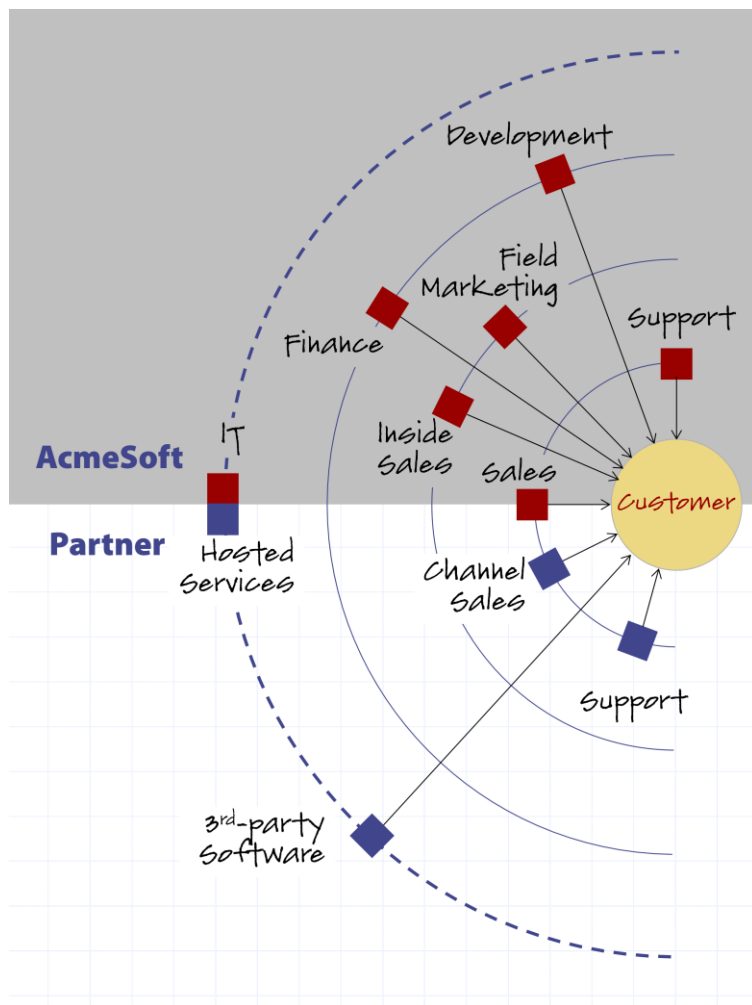
Who are the natural stakeholders who should create the COE?

The three Ops groups – Sales Ops, Marketing Ops, and Channel Ops – stand to benefit the most from such an initiative. The other critical partner is IT because of technology’s role in institutionalizing the process (and policy) changes.

Does the COE need an executive sponsor?

In the case of Supply Chain during the 90s, CEOs created an executive position with the authority to tear down the walls between the functional silos. This executive sponsor is more or less the equivalent of a Demand Chain “czar,” but as to whether it is a formal designation is another topic altogether.

Ultimately, there is only one “czar” who is accountable across all functions, i.e., the entire value chain, and that is the CEO. And if CEOs are relentless in tearing down the walls – inside and outside the walls of their business – then these “czar” designations aren’t that important (and good policy can mitigate this need as well).



When is the right time for change?

The quote (on the left) is unfortunate, but true.

As much as we would like to think that knowledge alone inspires people to change, in reality it is often not the case.

In today's economic conditions, many companies are feeling tremendous "heat" and change is happening under unpleasant conditions where it is "all sticks and no carrots." Unlike these companies, AcmeSoft is in a position to be proactive and embrace change in a far more positive environment that is conducive to sustainable change.

A statistic to keep in mind about getting a head-start. AMR Research (now Gartner) has been tracking the Top 25 Supply Chains for over 10 years and about 60% of companies are consistently in the Top 25 year after year. Those who started out early kept widening that lead year after year. For AcmeSoft, the Demand Chain presents that kind of opportunity. It opens up the art of the possible and helps visualize the best path forward in the Operational Excellence journey.

But it all starts with a few change agents, both from within the enterprise as well as AcmeSoft's ecosystem, with whom to collaborate, share ideas, formulate a common vision for the Demand Chain, socialize these concepts and help catalyze and accelerate change – and faster than the competition because the knowledge is available to everyone.

For the right kind of individual, these changes can be exciting and rewarding. The goal of this paper, as stated up front, is to begin such a conversation to understand the possibilities.

*People seldom change when they see the light...
...it's often when they feel the heat.*