How COOs are transforming for the future while getting back to basics

COO roundtable

In an EY COO roundtable, C-suite leaders describe how they are balancing needs as operational excellence and profitability grow more vital.

Today's economy continues to point in different directions at the same time, with surprising resilience sitting alongside persistent weaknesses, sharply divergent by sector and by geography. Amid this uncertainty, and as interest rates are likely to remain elevated, chief operating officers (COOs) are doubling down on operational excellence, focusing intently on productivity, working capital and targeted digital initiatives.

In our COO Roundtable, organized by the EY Center for Executive Leadership and hosted by EY Americas Consulting Vice Chair Raj Sharma, we gathered virtually many operations and supply chain C-suite leaders to talk through top challenges, with insights from Gregory Daco, EY-Parthenon Chief Economist.

In a sense, COOs had one eye on the past — to regain pre-pandemic cost and service performance as inflation moderates and as labor and supply disruptions begin to resolve — while also looking to the future with advances in technology, such as artificial intelligence (AI) and automation.

However, the cost of capital presents challenges, forcing COOs to measure the need to transform against the reality of today's balance sheets. Here's how leaders are walking this tightrope and what they revealed about a business environment unlike any other in history.

Confronting a desynchronized economy

Daco was challenged to make sense of an economy that is more "desynchronized" than ever — in which yesterday's laggards are often thriving today. "This is difficult to navigate because typically you have regions or countries that are trade partners that grow in sync — but not now," Daco noted. China, once the engine of global growth, has fallen behind because of headwinds in real estate and industrials (although its electric vehicle and biotech sectors are strong). Activity in Europe is subdued and trending toward recession for some countries, particularly eastern countries, while the US has been resilient — and atop it all, geopolitical fissures are opening up globally, adding another complicating dimension.

Three other themes worth noting:

- Labor has become a key pillar of the economy. We had seen a hit to labor during the pandemic but then a rapid recovery followed. Now, labor remains important, but the cost of it is starting to bite, pressuring COOs to moderate the impact through gains in productivity.
- Inflation is no longer a one-way bet. Last summer in the US it was 9%; now it's close to 3%. "As I like to say, the free disinflationary lunch is over," Daco said. "There's a sentiment of cost fatigue in the discourse. You're starting to see shades of slower demand."
- The cost of capital is now "higher for longer." Traditionally, central bankers take the escalator up but take the elevator down — as in, raise slowly and cut faster — but this time it's been the opposite. "We're not going back to the free money era anytime soon," Daco commented.

Participating COOs affirmed that they were already taking action with these themes in mind to counter softening demand and cost-price mismatch — for example, by prioritizing smaller, quicker capital projects and focusing on reducing working capital and by optimizing return on assets either by underwriting capex or by calibrating asset ownership (e.g., pursuing an asset-light strategy).

"The view was that at some point we were going to hit a recession — that made us think conservatively," one noted. "Pricing power will be weaker, but we're working on productivity. And we're not cutting back on continuous improvement and digitalization."

Another added that these actions were always timely: "A combination of circumstances have created a focus on those things, and the market makes it easier to make the argument. But the real reason for refocusing on these areas is that we haven't been good at them."

Action items for COOs:

- Revisit inventory management and working capital. In this environment, the cost of goods is as important as the cost of money, and many companies have gone from "just-in-time" to "just-in-case." "We have to get everyone off the inventory drug," one COO of a leading Consumer major said. These buffers have a price associated with them that have grown unsustainable. Becoming asset-light, to the extent possible, takes on new importance.
- Consider the broader spectrum of productivity and efficiency – including technology, efficient processes and trade – to gain agility and resiliency, which are the ultimate antidotes to supply shocks, high labor costs and political uncertainty.

Operations and supply chain reimagination

Against that economic backdrop, operations and supply chain remain board-level topics for C-suite executives, including for the COOs in our meeting. Digital technologies such as AI and automation are being used to trim costs and leapfrog toward innovation faster, which in turn requires a closer look at global architectures and operating models.

There's greater pressure among COOs on raising the bar for efficiencies, with a re-emphasis on supply assurance and resiliency coming out of COVID-19. Executives want to know how to prioritize their resources amid all these priorities — because they don't have the team size, talent is short, investment is constrained and their own time is limited.

"Part of the secret is to tackle more than a handful of priorities at a time," one COO noted. "We can't do it sequentially."

In the discussion among COOs, they zeroed in on technology and its flipside — talent — as two particularly thorny areas. And they also noted that cost and profitability pressures are higher than before after some laxness in the wake of the pandemic. "Getting back to basics" was a common theme.

"We've almost had to retrench on what capabilities do we need now and the tech competencies that people need to have," a COO said. "With COVID, the world moved with regard to digital and skills and capabilities in critical roles."

Another added: "The biggest struggle for us to make change happen is realizing that so many of our people were retiring early. And with shortages of labor, the people we hired didn't have those skills. For us, it's big."

And after making investments in technology, another participant circled back to the persistent dilemma with talent: "You can have the greatest tools in the world, but if the people who use them are not proficient, you end up only working on adoption and not improving performance further."

Today, tech is not a shiny object for companies to pursue — it's the reason for their existence. Yet EY research shows that up to 70% of digital transformations fail, and the gap between digital haves and have-nots has increased. COOs need to be focused on questions such as: Can your organization get beyond pilot projects? Are your digital efforts fragmented and lack end-to-end clarity? Have you focused on building ecosystems and centers of excellence? And are you orchestrating around a human in the center?

Two COOs who participated shared their lessons learned during their recent transformations — including efforts such as cleansing data, putting it in data lakes and warehouses across functions, simplifying tech stacks, and connecting information and data flows and systems capabilities:

- Plan several years of sustained, incremental investments to demonstrate value and then reinvest the money that you've saved.
- Focus on the blockers that subvert the flow of your information and products. "Maybe it's a point where the product stops for testing, or if an order doesn't get all the way to cash because maybe pricing is inconsistent," a Health and Life Sciences COO said. When you tackle the biggest disruptions, the scaling question goes away.
- Pilot different solutions in different places, then bring the team together to assess which worked best. "It allows us to *Shark Tank* different ideas and then steal them for elsewhere in the organization, because the results are proven," one participant said.

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