The seven principles of supply chain management

By **Barry Elliott**, partner, Oliver Wight Asia Pacific

> "The nicest example of this that we've seen was the maker of canned soup. They made many private label products but the only difference was the label; the contents were identical. Rather than keeping lots of stock of all of them, they reduced their stock of semi-finished product and just labelled to order"

One of the distinctive things about supply chain management is that there are so many different views about definitions, scope, approaches and so on. One perspective that we have liked over the years is one which comprises the seven principles of supply chain management.

We think that these principles provide a good structure by which you could form your supply chain strategy. Just as an aside, though, we have often wondered if, in fact, the term "supply chain strategy" is actually an oxymoron. What do you think? By the time that you start thinking about supply chain issues, shouldn't you actually have your business strategy straightened out already? So, aren't we actually already down to the tactical level?

In any case, we wish to help you think through how you could and should tackle the job of improving management of your supply chain. There are seven principles; their applicability to your situation is what you need to consider:

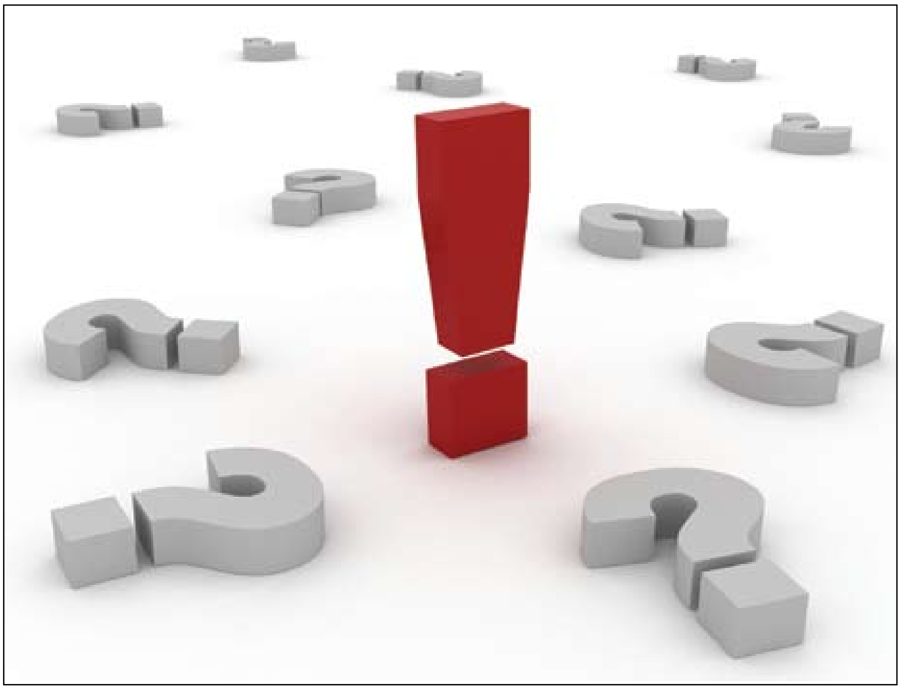
- **Segment customers based on their service needs:** Not all customers are the same, either in terms of the services that they need and those they are willing to pay for. Furthermore, you also need to take into account their value and profitability to you and your business. Are you sure that you make money on each sale? By being more thoughtful, analytical and "strategic", you may be able to identify several (not too many!) distinct groups and adapt the supply chain to serve these segments profitably.

  We did this a few years ago with a manufacturer of packaging materials, identifying how different the supply chain requirements were to supply to a beer company as compared to someone who wanted to buy just a few materials for their small business. But, the packaging supplier had been trying to deal with both extremes in the same way.
- **Customise your logistics network:** Once you know what your customer segments are, you will wish to customise the logistics network to the service requirements and profitability of each of them. In this case, we are using the term "logistics" to refer to the order fulfillment process, from time of query from a customer through to collection of payment for a purchase.

  We remember the case of a beer company where it was quite easily determined how it made sense to consolidate customers' deliveries more on type rather than geographic areas. For example, big retailers versus small volume restaurants.
- **Drive operations from demand:** Listen to market signals and align demand planning to ensure optimal resource allocation. Whether you manufacture or procure product or manage a services business, you have resources to optimise and the closer that you can align your supply to demand, the better your bottom line will look.

  We worked with a manufacturer of household cleaning products who set up a so-called Run Strategy, which set the optimal sequence products to be made. This sequence was followed on a regular cycle but the volumes to be produced were based on shorter term market demands.

- **Differentiate product closer to the customer:** Differentiate product and services closer to the customer to speed conversion across the supply chain. The later that you can make the final decision to allocate/tailor your products and services, the longer in the supply chain you can keep your inventory (again, of products or service resources) pooled for the most optimal allocation.
  The nicest example of this that we've seen was the maker of canned soup. They made many private label products but the only difference was the label; the contents were identical. Rather than keeping lots of stock of all of them, they reduced their stock of semi-finished product and just labelled to order.
- **Source strategically:** Manage sources of supply strategically to reduce the total cost of acquiring and owning materials and services. Amazing results have been achieved time and time again when organisations have simply taken a fresh, "strategic" look at how they source goods and services. This involves nothing more than getting back to basics and doing things in a common-sense manner.
  We have done a lot of this work over the years. It's amazing how, time and time again, total cost of ownership can so easily be reduced by 15 to 20%. The biggest and easiest category saving that we experienced, through just a bit of ingenuity, was just shy of 50%!
- **Develop a supply chain-wide technology strategy:** Support multiple levels of decision-making and give a clear view of the flow of products, services and information. Also, this technology strategy incorporates all forms of technology, not just IT.
  Only once you've got your people (understanding and behaviours) and processes right, turn to technology for optimal efficiencies and quality.
- **Use supply chain spanning performance measures:** Gauge collective (that is, together with your trading partners) success in reaching the end-user effectively and efficiently.
  What gets measured gets done. People behave based on how they are measured. Use measures to drive the appropriate improvements. All those clichés are valid. Expand the measures beyond functional lines to achieve the collaboration that you need across your supply chain.



We have used these principles in several situations to put together a supply chain "strategy". As a template, it works well. However, typically the major initiatives that make up the improvement programme end up being some combination or variation on these themes because they must be interpreted and adapted to suit each particular – and sometimes peculiar - environment.

There are significant benefits to be accrued overall from taking this approach and each of the principles effect improvements in their own right. As with all well executed business improvements, the benefits ultimately show up as increased revenue, improved asset utilisation, and reduced cost. Obviously, the magnitude of potential benefit will depend on your starting position, but claims are common that you can achieve 15 to 30% reduction in warehousing and distribution costs, anywhere up to 30% reduction in inventory levels (even beyond that, actually), and a 10% increase in sales, directly attributable to these efforts (simply due to increased availability and service levels).

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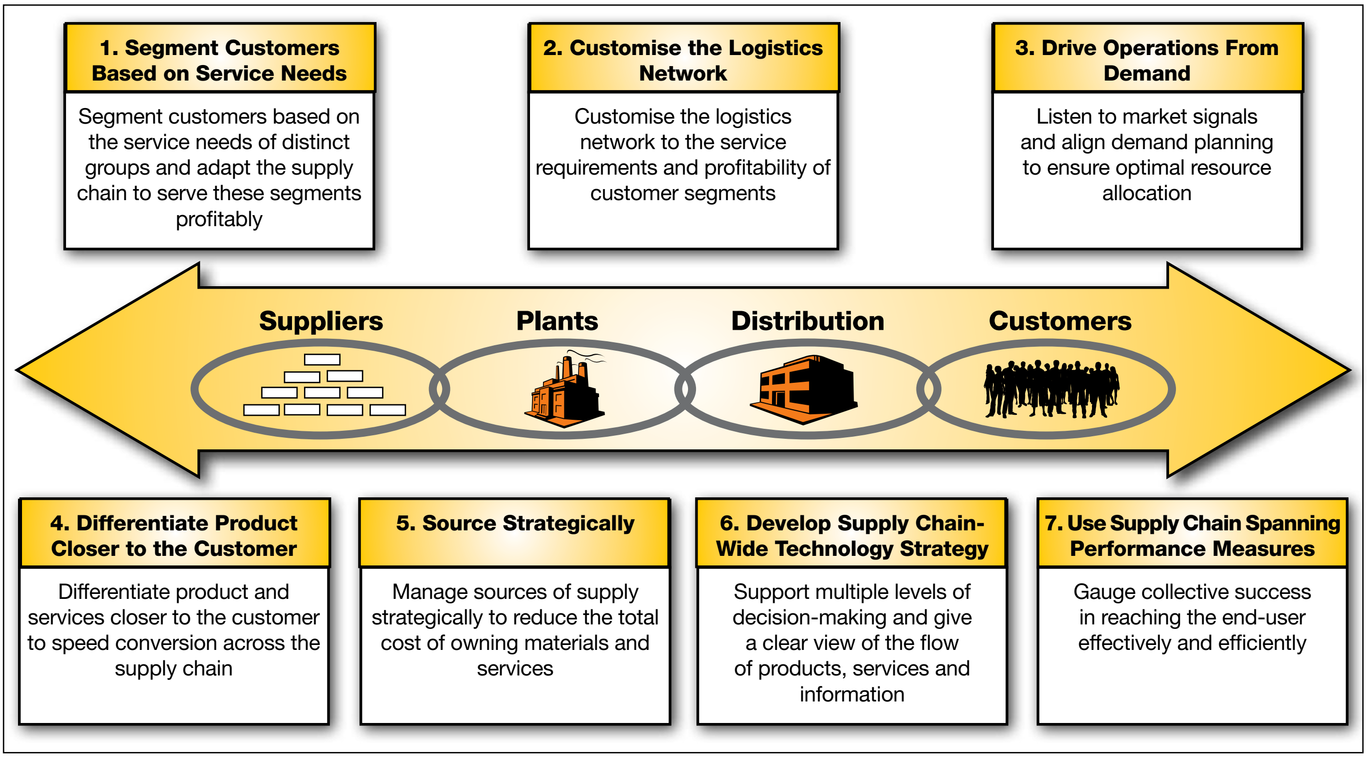
While the theory is that you mix and match these principles to create a customised system that is simultaneously implemented, transforming your company into the slickest, most efficient thing that the world has ever seen, the reality is that there are likely not enough resources within any organisation to take such a broad stroke at one time.

Therefore, the question is – which step to take first?

Strangely enough, it is the guys in marketing that hold the answer.

Marketing and sales types think differently from delivery and logistics people. Rather than being concerned with the nitty-gritty practicality of service and delivery, their world is often viewed as revolving around fluffy "ideas" and "concept" kinds of things. Behind this, however, marketing people are driven by a single objective: how to best reach the



market, knowing full well that they cannot approach every customer in the same way.

So, let us begin with what is the logical first step: look at your market and figure out how to best serve your customers. From there, you could subsequently work back to configure your operations accordingly.

There are three questions that marketers ask: Who are your customers? What do they really want? What are they willing to pay for?

That final question is the key one. What are they willing to pay you to do or to provide? Most companies have customers across the entire spectrum of service requirements, ranging from the high order quantity/high delivery frequency end to the "mom and pops" that only order a little at a time, once in a while. Some clients only need the basic product from you, with no frills service, while others are looking for you to act as a one-stop shop and are willing to pay for the core product or service plus many value-adding services. The marketing and sales folks tailor their efforts around understanding and satisfying the demands of a clientele that they view as coming in a wide range of shapes, sizes and every colour of the rainbow.

Many (maybe even most?) organisations view their supply chain in monotone, offering a product or service that they simply push out to the market. Over time, the basic proposition has been supplemented with extras, again either a product or service, and the assumption is often made that all customers want and value it. That they are willing to pay for it.

So, if the traditional approach of "Treat all customers the same" isn't the best, can we go to the other extreme, "Treat all customers individually"? That is, set up a dedicated supply chain to service each? Of course not.

How can you satisfactorily, profitably, service all of these types of customers with a single approach? By looking at it from a different angle. This approach is very familiar to people in marketing and sales but less so in customer service delivery and supply chain management. You need to determine groups of customers (segments) with common characteristics and then serve them similarly.

The key, with respect to improving your bottom line, is to assess which customers are most valuable to you, with respect to either profit or some other factor. Are you making money on every customer, every order? Do you have the means to measure that and to know the answer?

This approach has been taken by manufacturers and distributors around the world. Typically, they set up a project team and conduct a great deal of analysis of their customer base, looking to understand the customer needs and the value of each customer to their company. Looking at the results and findings from the analyses, they then determine the best customer segments for their situation.

After this, they then proceed to do three things:

- Tailor the value propositions
- Align the supply chain to each segment
- Develop and implement the appropriate supporting processes, people/organisation elements, and systems

The results are invariably outstanding. They improve customer service; it is easier to define and achieve clear order-winning and customer-satisfying service objectives. They lower the cost to serve, achieving cost reductions usually equal to roughly 5% of revenue. The management teams are always confident that they increase their top line but, of course, it is difficult to quantify how much of their increased sales are attributable to the new approach.

One of the most significant things that they are able to identify and quantify is proven to be a key element to the future of their business - over time this new, market-oriented approach to logistics issues leads to a shift in the client mix to the higher value customers.

We will continue discussing others of the seven principles of supply chain management in future articles.

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