Why Companies Flunk Supply-chain

Miles Cook

In today's just-in-time delivery of goods, supply chain has become very important for companies. Efficient supply chains not only lead to huge cost savings but are also a source of competitive advantage for companies. Though more than 85% of the companies admit the importance of efficient supply chain, only 33% correctly measure supply-chain performance. The article discusses the four main reasons for companies failing to have an effective supply-chain in place and what they need to do to overcome the deficiencies.

More than 85% of senior executives say improving their firms, supply-chain performance is one of their top priorities, but fewer than 10% are adequately tracking that performance. And fewer still—7%—collect the information necessary to meaningfully measure their progress. Those are key findings from a new survey by Bain & Company.

The study, which polled 162 top managers with supply-chain oversight, also finds that the supply-chain gap is set to widen: Two-thirds of companies that say they are already ahead rate improvement of supply-chain performance as a “high” or “top” priority; but just over a third of laggards say they will prioritize catching up.

The consequence is a growing performance gap between average firms and the exemplars—companies such as Wal-Mart, Dell, and Toyota that meticulously analyze everything from customer forecasts to product pricing to warehouse inventory turns. Already, the top performers are twice as efficient as the average. Independent research shows they put about 4% of revenues into their supply chains, while average players allocate almost 10%. (See Figure 1)

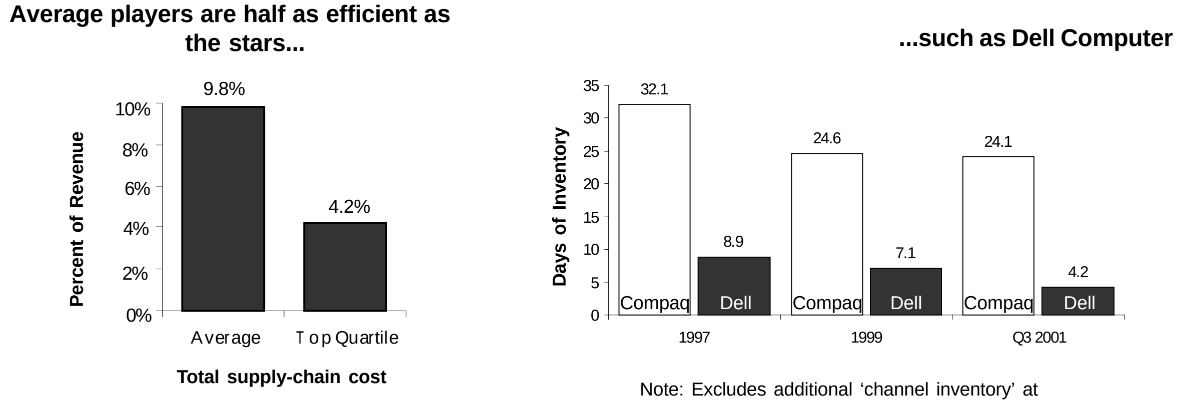
On many other measures and across multiple industries, the leaders, two-to-one performance advantage shows up again and again.

What’s more, the leaders are extending their lead. Dell Computer is a great example. For almost a decade, analysts have praised the PC maker for operating a lean supply chain, contrasting it favorably with traditional competitors. But even though its competitors have invested to improve, Dell has actually managed to extend its lead. In 1996, Dell kept 15 days of inventory—half that of rival Compaq. Last year, Dell’s inventory was down to almost 4 days while Compaq’s was still at 24.

So why are some companies flunking supply chain basics? Bain’s research uncovers four reasons:

- **Most companies are hazy about their supply-chain performance.**
  Only 15% say they have full information on what's happening in their own companies. (See Figure 2) Even among firms that say supply-chain improvement is a priority, slightly less than two-thirds say they’ve got all the necessary information.
- **Too many companies are supply-chain introverts.**
  In other words, too many companies fail to adequately recognize that the supply chain extends far forward to customers, and back, to suppliers and their suppliers. Our study showed only 7% going outside their four walls to track the performance of supply-chain activities at their vendors, logistics providers, distributors, and customers. (See Figure 3)
  Imagine how difficult it is for a supplier to plan production effectively when a key customer withholds forecast data.

Figure 1

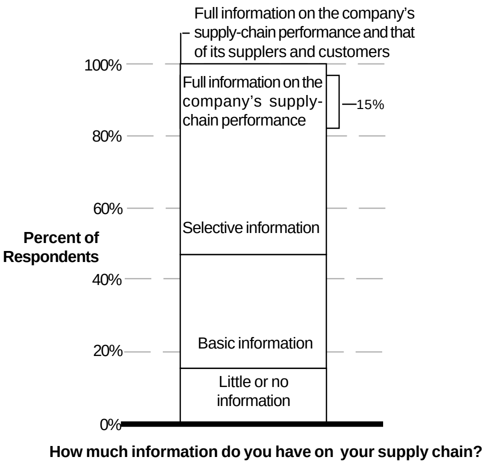


Source:PMG’s 1999-2000 Supply-Chain Management Benchmarking Series

Note: Excludes additional ‘channel inventory’ at Compaq resellers of 2-4 weeks

Source: Onesource

Figure 2: Only 15% say they have good information on their supply chains



Source: Bain & Company

The benefits of opening up are many. If Ford had not built solid links to suppliers and customers, it couldn't have handled its huge recall of Firestone tires as effectively as it did in late 2000.

- **Incentives don't tie to supply-chain improvements.** Only two out of five survey respondents said their companies use pay-for-performance rewards to motivate their supply-chain executives. (See Figure 4) But, even those doing so, often make the mistake of using the wrong targets. Almost 80% of those incentives fail to take into account customer feedback and vendor results. Companies that reward buyers when they avoid running out of stock, but don't offer anything when they improve inventory turns, are penny-wise and pound-foolish.

  It's just as bad when transportation managers are measured on delivery cost but not on on-time performance. By using the cheapest, slowest route, a fortune can be lost in carrying costs, speed to market, and lost inventory turns.

  The supply-chain leaders go further, fostering collaboration between key functions such as purchasing and distribution.

- **There's still a bias toward quick IT fixes.**

Businesses have looked to sophisticated software to solve their supply-chain problems. Yet most turn their inventories no faster than they did a decade ago. Asked to rate a list of six ways to improve their supply-chain activities, respondents gave the highest weighting—21%—to "Rebuild our supply-chain IT systems." A more fundamental solution—"Improve our supply-chain talent"—was cited by just 14%.

So what can businesses do right now? They can emulate the supply-chain exemplars by sticking to these five fundamentals:

Get the Strategy Right First

Most managers are unclear about their firms' strategic underpinnings. So it's not surprising that they don't know which supply-chain improvements can drive real advantage, which service enhancements customers will value, and how they should hook their operations into those of suppliers and customers so the whole chain is competitive. Many still believe that supply-chain software will sort things out. But technology can't atone for flawed processes.

Put Star Players on the Problem

Supply-chain roles are rarely seen as glamorous. But the supply-chain maestros such as Dell set plenty of store by them. They recruit top-caliber people who can save them millions of dollars with better forecasts, vendor strategies, and execution. The best companies also work to align many departments under a senior executive whose job is to plan, measure, and optimize the performance of the whole chain—both internally and externally.

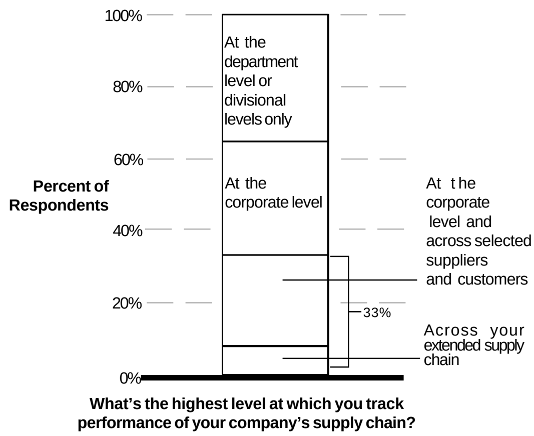
Replace Hunches with Metrics

If you don't track performance—the performance of the whole supply chain—you're in the dark about what your supply-chain inefficiencies cost. Yet many companies are guessing when setting inventory targets. They don't know how much of their products will sell at what prices, and they don't analyze what they've sold at different prices. So they leave money on the table—or overpriced goods on shelves. Look at the retail sector: Leaders such as Wal-Mart are now starting to use their supply-chain skills for sophisticated management of shelf placement and pricing. Rather than taking the typical approach of "art over science" in allocating product space, the leaders analyze what moves and moves profitably, and then assign space and set inventory based on product attractiveness.

Reach Past Your Four Walls

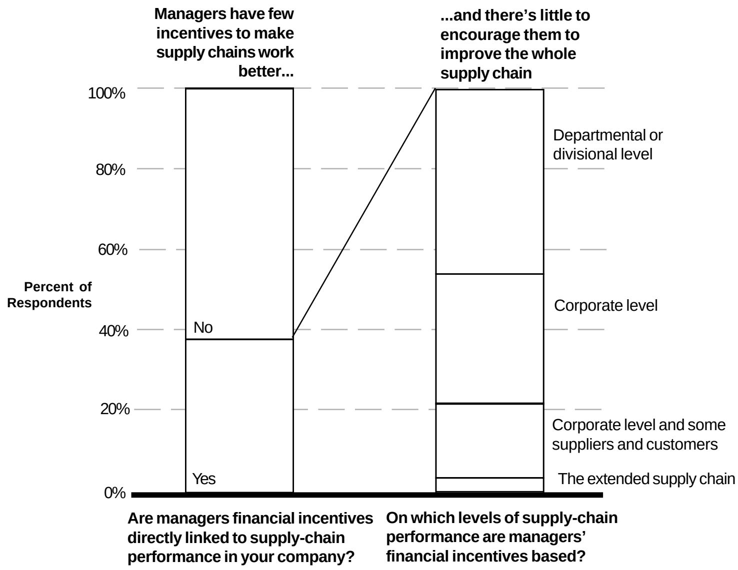
The best performers have already linked their operations with those of their customers, suppliers, and logistics providers. They know their own performance metrics,

Figure 3: Only a third of businesses track supply-chain performance outside their four walls



Source: Bain & Company

Figure 4



Source: Bain & Company

and those of all partners in the supply chain. They have visibility from the beginning to the end of their supply chains, and can make cost and volume adjustments before it's too late.

Not All Parts are Created Equal

A sure-fire sign that your supply chain is unhooked is when everything flows through it the same way: All vendors deliver on the same terms; every item is stocked in every distribution center. Best practice means managing multiple supply chains, and having options.

With real growth so elusive nowadays, the supply chain is an essential place to look for gains. It's a real source of competitive advantage, as the industry leaders have proved. They continue to prove it: They're accelerating so fast that they may never be caught. So who has a chance to catch up? The businesses that understand that supply-chain practices have to run on data, not on instinct.■

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Supply Chain Strategies in the Information Economy

- **Efficient Supply Chains:** Cost reduction in the supply chain can be achieved by eliminating non-value-added activities, achieving economies of scales, deploying optimization techniques to get the best capacity utilization in production and distribution and establishing information linkages for more efficient, accurate and cost-effective transmission of information across the supply chain.
- **Risk-hedging Supply Chains:** Depending on a single vendor for supply can increase the risk in supply disruption. Instead of depending on a single vendor, companies should move towards pooling and sharing resources in a supply chain. Sharing and pooling of resources also reduce the cost of maintaining the resources.
- **Responsive Supply Chains:** To meet rapid change in customer demand, supply chains need to be responsive and flexible. To be responsive and flexible, companies need to use build-to-order and mass customization processes. Accurate specifications of the customer requirements is the key to the success of mass customization.
- **Agile Supply Chains:** Supply chains need to be both responsive and flexible to the customer needs and at the same time hedged the risks against the supply shortages or disruptions by pooling their resources. In other words they combine the strengths of both hedged and responsive supply chains.

Supply Uncertainty	Demand Uncertainty: Low (Functional Products)	Demand Uncertainty: High (Innovative Products)
Low (Stable Process)	Efficient supply chains	Responsive supply chains
High (Evolving Process)	Risk-hedging supply chains	Agile supply chains

Adapted from Lee L. Hau, "Aligning Supply Chain Strategies with Product Uncertainties," California Management Review, *Vol 44, No. 3, Spring 2002*