

Top three supply-chain hurdles holding businesses back

Jérémie Gallien puts the success of firms such as Apple and Zara down to a deep understanding of their supply chain's function and shares how to rally stakeholders and the individuals providing supply-chain leadership

1 Metrics that top management understand

Supply chains efficiently move goods from vendors to customers. They're critical but notoriously challenging for firms. The supply chain is an electromagnet for information essential to optimising firm-level decisions – it's where production, sales and marketing plans naturally converge. But how can top management and other functions be expected to recognise and leverage this potential when supply-chain professionals all too often fail to themselves?

Two main components make up supply chains. The first is the engineering function – the logistical element of moving things around. The second is the business function – the coordination and planning activities aimed at matching supply with demand. The problem is that common supply-chain metrics often fail to speak to the concerns of top management because they focus on the engineering function at the expense of the business function. Sales executives use terms such as revenue, repeat business and customer satisfaction – metrics guaranteed to catch the attention of senior leaders. Meanwhile, supply-chain executives typically express performance with measures such as truck utilisation, load factors, picking productivity and worker absenteeism. These metrics, specific to the engineering function of supply chains, rarely reach the boardroom.

To appreciate this hurdle, let's take a taxi ride. Imagine the supply-chain



Jérémie Gallien,
Professor of
Management Science
and Operations at
London Business
School.

manager is the driver and the CEO is the passenger. Consider the impact if the driver failed to ask where the customer wanted to go and how much it would cost. Imagine the passenger's frustration if instead the driver described the cab's fuel consumption,

age of the tyres and performance of the engine torque using technical jargon. Many supply-chain professionals fail to use metrics that speak to senior management's concerns, just like this.

Nowhere is this opportunity clearer than with costs. Executives considering



supply-chain costs tend to mostly focus on the direct costs of activities such as transport and warehousing, which relate to the logistical function of supply chains. But where are the metrics to demonstrate success in matching supply and demand? Total cost of inventory and lost sales opportunities are both good examples of business-level metrics that are often ignored. This is what drove Hewlett-Packard (HP) to design a new total inventory metric capturing component devaluation, price protection, product return and obsolescence costs, finding along the way that inventory-related costs accounted for more than 40 per cent of its total supply-chain costs. When that new metric started to impact supply-chain redesign decisions, HP's mobile computing division reduced inventory-related costs from 18.7 per cent to only 3.8 per cent of revenue in just two years. Another good example is the American office supplies retailer OfficeMax, which reaped large benefits when it started to evaluate lost sales through daily measurement of stock-out levels in each store – the way they are experienced by customers – instead of considering warehouse-level stock-outs. With the tracking system RFID, companies like Zara go even further, as they are able to measure the lost sales incurred when store articles are left in fitting rooms or store backrooms, instead of the display shelves.

2 Bigger-picture coordination

Does the following sound familiar? The sales team inflated their forecast for fear of stock-outs. How about manufacturing resisted production-plan adjustments wanted by customers because of change over costs. Or a retailer understocked because it was bearing the full risk of any unsold inventory. These scenarios and countless others illustrate the important, practical challenges of coordinating supply and demand in the face of conflicting incentives and inefficient communications.

Obstacles exist both internally across functions and externally with suppliers and customers. Internally, local metrics such as revenue (sales), production costs (manufacturing), total-landed costs (procurement) and transport and handling costs (logistics) have a deep, powerful impact on behaviour. They're used to convey achievements on CVs, drive salary increases and promotions, and in turn impact the living standards of employees measured against them. For example, a purchasing manager evaluated on total-landed costs – let's call him David – selected a supplier from Asia and ocean freight. But David made the wrong decision for the firm because he was stuck in a local measurement silo. He would have selected a European supplier with ground shipping,

maximising profits for the firm if he was measured against higher level business costs, such as lost sales and leftover inventory. Sales and operations planning processes are challenging to deploy, but they can be effective solutions to local incentive problems and drive the success of firms as diverse as The Home Depot, Honeywell and Nestlé. Zara took an even more drastic solution. It went from vertical to spatial integration of its operational teams (such as product design, store management, procurement and distribution) into a single open workspace located in its Spanish headquarters. No doors, no walls or cubicles and certainly no emails to schedule meetings – just an open culture of walking over to the next desk to find solutions.

Externally, a major hurdle often complicating alignment with suppliers and customers is the challenge of convincing supply partners that accepting more market risks may be in their best interests. As tough as it may sound, this may unlock spectacular value. Consider revenue sharing agreements, which increased Blockbuster's share of the US video rental market in the 1990s by more than 50 per cent in less than two years. Buy-back agreements common in the publishing industry ensure that a retailer puts enough stock on its shelves to

maximise supply-chain profit.

Intel offers yet another example. Capacity option agreements ensure that a supplier has enough capacity for everyone to benefit from a market demand upside: Intel's recent use of equipment capacity option contracts has resulted in savings of tens of millions of dollars for a single process technology. Apple's advance investments in flash memory production capacity from 2005 onwards guaranteed a stable supply of components for the iPod nano, iPhone and iPad.

3 Professionals with both technical and leadership skills

How are these opportunities recognised and acted upon? The rarest and most sought after commodity in supply chains are professionals who possess both leadership and technical skills. They're the reason many supply chains outperform their competitors.

Why are they so hard to find? Because they must marry technical and leadership abilities which each come with their own set of recruitment challenges.

They must be adept across both the engineering and business functions. The same executive that makes decisions based on concepts and tools such as forecasting, inventory management, production planning, truck utilisation, lead-time variability and total-landed cost must also be good at motivating people, rallying large teams with a clear vision and working effectively with other functions.

Recognising high-potential supply chain professionals and giving them opportunities to develop is therefore more critical than ever. In fact, because supply chain leaders typically acquire broad, intimate knowledge of the firm and its partners, these positions are increasingly becoming training grounds for CEOs.

Guess what Tim Cook (CEO of Apple), Mary Barra (CEO of General Motors), Jeff Wilke (CEO of Amazon Worldwide Consumer), John Hendrickson (CEO of Perrigo), Fabian Garcia (CEO of Revlon) and countless others have in common? They all spent a substantial part of their careers managing supply chains before getting the top job.

Professor Jérémie Gallien teaches on the Supply Chain Leadership programme at London Business School. Next programme starts: 23 July 2017. For more information visit: www.london.edu/scl or call: +44 (0)20 7000 7324

