Half way there

Supply chain leaders firmly believe they are largely responsible for the future success of their businesses. But the business doesn't always agree, the findings of a landmark new report say

IF SUPPLY chain management is becoming increasingly important to the success of commercial business operations, why isn't this reflected in strategic business planning?

That's the primary question posed by a comprehensive new report into supply chain practice in Australia and New Zealand, which argues the sector may only be "halfway there" in making logistics management an integrated, end-to-end business solution.

The landmark research project was conducted between Portland Group, the Australasian Production and Inventory Control Society (APICS) and the Australian School of Business. Researchers set out to highlight current practices employed by leading companies to further optimise their supply chains and increase return on capital employed.

APICS Director Phil Heenan says the survey shows a high level of buy-in among senior management to supply chain operations.

"Overall results, however, do not match the enthusiasm of the players involved in the process," he says.

The supply chain function has increased significantly in importance to overall business success, according to the survey of logistics professionals drawn predominantly from ASX Top 200 companies across a variety of industry sectors.

Ninety percent of survey respondents stated the function is 'important to critical' today, up from the 45 percent who believed it was critical in the past. And virtually all participants (98 percent) indicated supply chain will be critical in the future.

Overall supply chain organisations are relatively mature with more than half of the companies having a senior supply chain executive at the C-Level.

Respondents indicate significant value is to be derived from improving supply chain management with over 75 percent suggesting combined cost reduction opportunities in excess of $250 million.

Manufacturers, distributors and retailers all see significant potential for inventory reductions totalling more than $1.6 billion among those organisations participating in the survey.

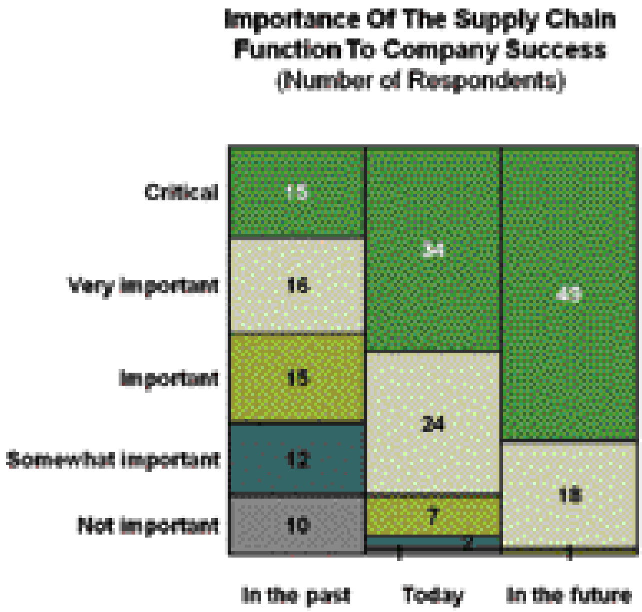
But that rhetoric doesn't necessarily support the perceived importance. The supply chain function is still seen predominantly as a business function rather than an end-to-end business process; nearly 60 percent of respondents' responsibilities are limited to logistics and supply chain planning.

This is further supported by the fact cross-functional barriers and truly integrated decision support tools are seen as the biggest challenge to improve supply chain performance. Although many companies use sophisticated analytical methods to support decisions, few have correspondingly sophisticated and well integrated IT tools, with almost all relying on spreadsheets for key strategic and operational purposes.

Worryingly, few supply chain staff have formal academic or professional qualifications, with recruiting largely based on functional experience and company knowledge.

While sales and operations planning seem to be a widely adopted practice, 61 percent of companies rate compliance 'moderate to poor' and many don't use the suite of supply chain key performance indicators to manage their performance.

Inventory management appears to be the weakest operational practice with 60 percent of respondents indicating forward coverage as the most frequently used method for managing inventory levels. Cost to serve tools, techniques and practices are applied by about half of companies surveyed.



PEOPLE AND PERCEPTION

All respondents had formal supply chain operations, but their age and remit varied significantly.

An interesting insight is that the supply chain teams that rated their organisation's supply chain performance as 'poor' were the oldest (9.4 years on average) while the teams that rated performance as 'world class' were the youngest with average maturity of only one-and-a-half years.

Respondents were also classified based on scope of the supply chain function. The survey shows manufacturers are most likely to adopt a broad scope end-to-end supply chain responsibility model, and retailers are least likely.

As the scope of the supply function increases it appears the perceived performance of the supply chain also grows. Sixty percent of the supply chain functions that have end-to-end responsibility judge the performance of their supply chains 'above average' or 'world class' compared to the narrower 'logistics' only scope of whom 54 percent perceive their supply chains as 'average' or 'poor'.

One positive indication of the rise of stature of the supply chain 'function' within organisations was that 56 percent of organisations have a supply chain director or vice president and 51 percent of supply chain functions report directly to the CEO (or equivalent) of their respective organisations.

The 'other' typically indicated a reporting line to divisional general managers, business units or other operating functions, such as sales.

Staff numbers in the supply chain were generally stable or increasing in 87 percent of surveyed companies, confirming the maturity of the function in most organisations. Staff growth appeared to be greater in organisations incorporating an end-to-end or multi-functional supply chain responsibility scope as opposed to a more narrowly focused definition of 'logistics'.

Experience was found to be very important in the staffing and composition of supply chain departments, with most planners having 4-10 years of experience and most analysts having 2-7 years experience under their belts.

In terms of skill-sets sought when hiring staff, functional skills and company knowledge are key determinants when recruiting supply chain staff — external hires and internal company transfers (from other business functions) were the predominant sources of new supply chain staff.

Only limited use is being made of highly educated supply chain recruits, mostly by multi-national companies (such as consumer products goods manufacturers).

Worryingly, few planners and analysts have formal professional training qualifications, with less than one-fifth of supply chain planners or analysts having any sort of supply chain academic or professional training. It raises obvious concerns regarding the commitment of organisations to invest in the human capital of their supply chains.

THE FUNCTION AND ACCEPTANCE

The survey participants clearly feel they have won the battle for strategic acceptance in the majority of businesses, with 90 percent of respondents agreeing it is a critical function driving bottom line benefits and/or an important function with a 'voice at the table'.

It's a significant achievement in itself, when the voice of supply chain was struggling to be heard in many organisations or was perceived to be of lesser value to the business than other business functions.

One of the more notable findings of the survey was the majority of participants saw significant

Given the current global and regional economic outlook, supply chain functions are likely to see increased pressure to deliver...

The majority of supply chain managers believe significant cost reduction is possible

opportunities for further improvement in their respective supply chains, with over 75 percent of participants indicating they see further potential for operating cost reduction. The estimated total cost reduction opportunities were in excess of $250 million for the participating organisations in the survey.

Manufacturers and distribution-oriented organisations perceived the largest potential for operating cost reduction in their supply chains, at almost 7 and 8 percent cost reduction potential respectively.

When viewed by the size of the supply chain (as indicated by annual operating cost), those organisations with less than $20 million/year in annual supply chain operating costs saw by far the largest potential for cost reduction, with a potential to reduce costs by 17 percent. Mid-size ($20-100 million operating cost) and large organisations (greater than $100 million) saw much less potential for operating cost reduction at 6 percent or less cost reduction potential.

Contributing factors to this lower perceived potential for savings would likely include the greater challenges in implementing change in larger organisations as well as the potential savings already achieved in past improvement initiatives.

Finally, those organisations viewed as mid-tier in the operational complexity of their supply chains (several sites and many products, but not the most challenging operational complexity environment) saw the largest potential for cost reduction, with a potential for approximately 9 percent cost reduction.

A similar view was held with respect to the organisational grouping of firms regarding supply chain planning complexity, with those organisations categorised as mid-tier perceiving they have the largest opportunity for cost reduction.

Most survey organisations also saw significant potential for inventory reduction in their supply chains, with manufacturers, distributors and retailers all seeing significant inventory reduction potential (with almost 20 percent inventory reduction potential in the case of distributor organisations).

In terms of the opportunity for inventory reduction by organisational size, while organisations of all size categories saw potential for inventory reduction, it was those organisations with the largest chains (in terms of operating cost) that saw the least potential in this regard, similar to the lower estimated potential for reduction in large chains.

Finally, those organisations that had the most complex supply chains also perceived they had the greatest potential to reduce their total inventory holdings, with organisations in the high-end for both operational complexity and planning complexity perceiving they had the greatest opportunity to reduce their total inventory. A commonly held view among survey participants was that higher levels of inventory were a common compensating factor for the increased complexity in these two dimensions.

Overall results, however, do not match the enthusiasm of the players involved in the process.

FUTURE CHALLENGES

Organisations listed a number of challenges to improving overall supply chain performance — some of the more frequent responses included:

- Cross-functional barriers in the supply chain
- Lack of information technology systems and integration
- Lack of a formal supply chain strategy in the organisation

- Magnitude of the changes required
- Cost to achieve the changes or improvements
- Lack of supply chain performance incentives.

Lack of IT systems functionality and integration ranked as the most significant challenge to achieving improved supply chain performance. That might be surprising given the attention and investment given to information technology over the past years.

It appears many organisations find it challenging to make efficient use of available supply chain software systems and are finding it difficult to keep up with the pace of advanced software development.

Formal tools are generally used more frequently (than MS Excel for example) in operational situations in manufacturing, especially for tightly integrated applications such as performance reporting.

The high reliance on spreadsheet software across supply chain functional areas is surprising (notwithstanding the pervasive nature of this particular application in business today). The extent of linkages between this high use for key supply chain functions, their relatively non-integrated nature and the supply chain cross-functional operating challenges fostered by their use certainly merits further exploration.

Organisations surveyed do, however, have a variety of plans in place to address their respective IT situations. These include initiatives to improve integration with their current IT tools, moving forward with new ERP systems and proceeding with targeted software tools for specific functions.

The next most significant challenges in order of impact were cross-functional barriers in the organisation: the magnitude of the changes required, the cost to achieve the change, and the lack of a formal supply chain strategy in the organisation.

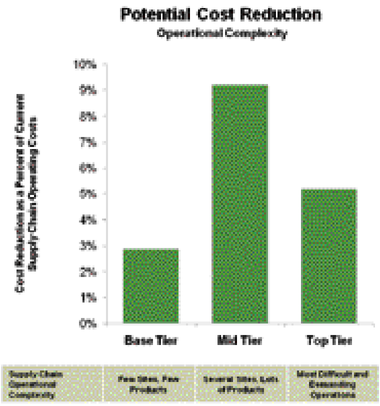
There were a number of other challenges to improved supply chain performance that fell into the 'other' category. These included a host of contributors, including organisational complacency, issues with external suppliers and insufficient skills within the supply chain team.

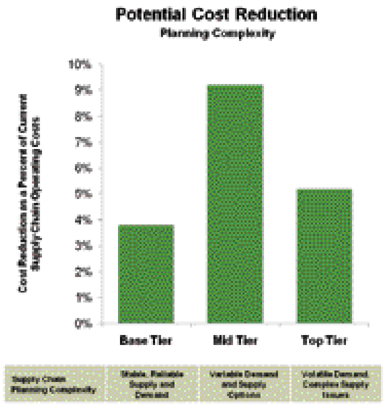
Meanwhile, respondents reported a high-degree of executive involvement in sales and operations planning, with 'always' being the most frequently reported answer and was highest in retail. The report describes this as a positive sign and an indication of the importance being placed on cross-functional supply chain management in many organisations.

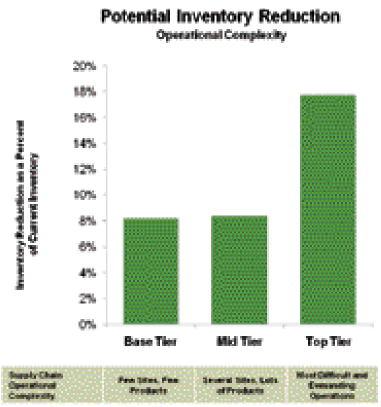
On the key issue of how trade-offs in the supply chain are managed (for example between cost, service and inventory) informal and formal decision making were approximately equally prevalent in managing the tradeoffs, with optimisation modelling a distant last.

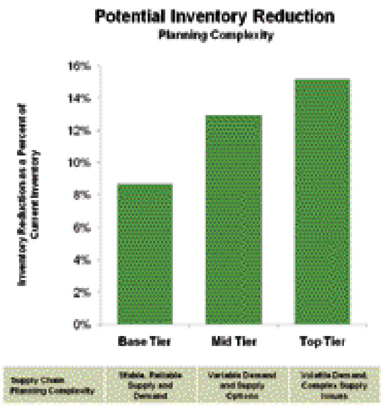
As for the oft-sought linkage and integration of sales and operations planning with financial forecasts, a majority of respondents indicated this function drives financial forecasts, but for a substantial minority it clearly doesn't.

A clear opportunity for improvement in this area is in how effectively organisations are adhering to the plans they establish. Most organisations rated themselves as either 'good' or 'moderate' in this









regard, at 48 percent and 42 percent respectively — acceptable, the report says, but certainly not outstanding.

"Given the importance of this issue in managing overall supply chain performance, it is concerning such a large percentage of organisations manage key trade-offs via informal or ad-hoc decision making methods," the report states.

"If a large degree of trade-offs (and the plans these trade-offs generate) are arrived at informally or on an ad-hoc basis, it is possible that the effectiveness of these plans (or certainly the confidence in them) is questionable, thereby leading to lower plan adherence."

A variety of performance measures are used to measure and manage overall supply chain performance, with DIFOT and financial measures being the most common. The report notes a large number of organisations do not have specific measures for overall supply chain outcomes.

Given the current global and regional economic outlook, supply chain functions are likely to see increased pressure to deliver on the perceived cost and inventory reduction opportunities.

Supply chain leaders, the report argues, will need to carefully consider how they overcome the challenges identified in the survey and reach outside the boundaries of their own organisations to deliver the outcomes sought.

A copy of the report and further information is available via the Portland Group. Contact Olaf Schatteman (Sydney) on 02 9210 4300 Tom Zielinski (Melbourne) at 03 8825 3802.