
References

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Is your top team undermining your supply chain?

Building bridges between senior managers is a critical step in constructing tomorrow's global supply chain.

Creating a global supply chain that is equipped to thrive in a world of rising complexity and uncertainty involves more than reconfiguring operational assets and making long-term strategic bets about production-and supply-related risks. Significant organizational challenges are involved, too, since the decisions and activities of a company's supply chain group influence (and are influenced by) the sales team, marketers, and product developers, among others.

The result is a host of thorny trade-offs. Should a company, say, move a product to a low-cost manufacturing facility to save money if that means lengthening delivery times? What if trimming the company's product portfolio to reduce manufacturing complexity and costs could stifle marketing efforts to reach new customers? When do the benefits of improved customer service warrant the additional operating expenses required to deliver it?

Supply chain, sales, and marketing managers invariably view such trade-offs through the lens of their own responsibilities -- and this perspective often leads to disagreements or misunderstandings. Indeed, a recent McKinsey survey of global executives cited the inability of functional groups to understand their impact on one another as the most common barrier to collaboration for resolving the major supply chain trade-offs.

Ineffective collaboration has long been a supply chain sore spot, but its costs are set to rise drastically. If it's hard to agree on the right response to a disruption in a supply chain today, it will be more difficult still when companies deal with multiple interconnected supply chains, each possibly requiring a different solution. And consider the short- and long-term supply chain trade-offs executives must balance in a world where one business unit might be asked to shift its manufacturing lines to a more expensive near-shore location today to build capacity as a hedge against potential future spikes in labor or transport costs.

Finding mechanisms to solve these and other difficult supply chain questions will require hands-on attention from the CEO and other company leaders. The process begins when executives work together to identify places where better information sharing and teamwork will generate the most impact. Let's look, then, at three of the biggest collaboration tensions we routinely observe and see how companies are bridging these organizational divides to create more flexible and capable supply chains.

Tension 1: Supply chain versus sales

Supply chain organizations wage a constant battle against volatile demand, and for good reason. An unexpected spike in orders, for example, has expensive consequences in labor and distribution costs. Similarly, inaccurate sales forecasts can lead to stock-outs, lost sales, or excess inventory that must be sold at a discount. Sales and supply chain groups therefore devote significant energy to creating sophisticated planning and forecasting processes in an attempt to predict demand volatility -- and blame each other when things go awry.

When these groups work together more closely, they can move beyond the traditional planning-cycle blame game, discover the root causes of volatility, and ultimately begin to influence it. This approach brings tangible business benefits -- often quickly. Crucially, over the longer term, the experience that groups gain from flexing their collaborative muscles heightens the ability to react quickly, and in a concerted way, to unforeseen events. That skill will be even more necessary given the increasing uncertainty in the supply chain environment. Here are two examples that illustrate the potential.

The first involves an automotive supplier whose sales teams often scrambled to meet quarterly targets that would guarantee them better performance bonuses. Customers recognized this behavior and, in some cases, were gaming the system by withholding orders until the end of the quarter to secure deeper discounts -- creating supply chain headaches and hurting the company's bottom line. The vice president of sales and the supply chain head collaborated to fix this problem and make demand more predictable. One key step: substantially trimming end-of-quarter discounts and instead using a price and discount structure based on sales volumes, product loyalty, and participation in promotional efforts. The company also created new incentives to encourage sales teams to spread sales more evenly across the quarter.

Our second example involves a global manufacturer of consumer packaged goods. This company discovered that promotional activity in just five customer accounts drove most of its demand volatility. Although it carefully planned the promotions to maximize revenues, its marketers hadn't thought about the impact on the supply chain. By staggering the promotions over several months and aligning them carefully with baseline demand patterns, the company reduced the overall volatility of demand by 25 percent.

When the company rolled out the new promotions plan, its managers identified another problem: many customers lacked the resources to manage their order levels efficiently and therefore sporadically placed unnecessarily large orders. The company responded by bringing together its sales and supply chain personnel and working with these customers to create better ordering processes for them. In this way, it smoothed the flow of orders -- a move that benefitted both parties.

Problems like these are endemic in many supply chains. By tackling these problems, companies often enjoy immediate benefits while building collaborative capabilities that will be crucial over the long term in the more complex and uncertain supply chain environment of the future.

Tension 2: Supply chain versus service

A second important tension that has long existed, but will become even more acute as companies seek to create more resilient global supply chains, involves the setting of customer service levels. How speedy should deliveries be? Should some customers receive orders faster than others? What levels of product availability should be guaranteed? In our experience, companies traditionally leave these decisions to the sales function, which often makes service-related decisions without understanding the operational implications or costs involved.

When these groups work together to analyze the full impact of a service decision, they avoid this pitfall -- a lesson learned by a chemical company whose sales personnel were pushing its logistics team to reduce delivery times to two days, from three. The company achieved this goal, but only by using more warehouse space and labor and by loading its delivery trucks less efficiently than it otherwise would have. All this increased distribution costs by 5 percent.

While this trade-off might have been acceptable under the right circumstances, a closer examination by the heads of the supply chain and sales groups revealed that most customers didn't mind if deliveries arrived in two, three, or even five days. The real breakpoint when service was most highly valued was 24 hours. By extending the delivery window for normal orders back to three days, the company returned its distribution costs to their original levels. Meanwhile, it launched a special 24-hour express service for critical deliveries, for which it charged a premium. The move ultimately raised the company's costs slightly, but this was more than offset by the new business it generated.

As supply chains splinter and companies diversify production to hedge against uncertainty, the importance of making smart trade-offs about service levels and speed can only grow. Companies seeking to cope will have to strengthen partnerships between the leaders of the supply chain, sales, and service.

Tension 3: Supply chain versus product proliferation

Remedying some of the root causes of growing supply chain complexity will be another important benefit of enhanced collaboration in the C-suite. Take the complexity associated with product portfolios. Sales and marketing organizations work hard to create new products, explore new market opportunities, and respond to emerging customer needs. As they do, products and variants tend to proliferate, creating portfolios with long tails of niche offerings. A consumer goods maker we know, for example, recently found that nearly one-third of the 6,400 SKUs[1] in its product portfolio together represented just 1 percent of total revenues.

This complexity comes at a cost, since low-volume products cost more to make per unit than high-volume ones (because of economies of scale). The consumer goods maker, for example, found that production costs for low-volume products were 129 percent higher than those for its best sellers. Low-volume products also require disproportionate effort in sales and administrative processes. Finally, they drive up supply chain costs: a company must hold higher inventory levels to meet agreed service levels across a broad range of low-volume products than it does over a narrow range of high-volume ones. When all these extra costs are taken into account, the impact can be eye opening. One company we studied found that 25 percent of its SKUs actually lost money.

In the face of these numbers, companies might be tempted to take an ax to the long tails of their product portfolios. Yet blind cutting based on sales figures alone often does more harm than good. Some low-volume products have benefits that outweigh their costs, and only through close collaboration across functional boundaries can companies make the right decisions. Such collaboration won't eliminate the need for more carefully segmented supply chain strategies, but it should help ensure that such efforts are well targeted.

Putting it all together

The top of the organization is the right place for most companies to begin negotiating the functional trade-offs we've outlined. But many senior-management teams give precious little attention to supply chain issues. Across the trade-offs our survey explored, for example, no more than 26 percent of the respondents said that their companies reach alignment among functions as part of the supply chain decision-making process. Moreover, 38 percent say that the CEO has no or limited involvement in driving supply chain strategy.

This is a mistake. CEOs set the agenda for their leadership teams, and it is up to CEOs to encourage and facilitate meaningful discussion of important cross-functional supply chain issues. CEOs can go further too. In some of the most impressive supply chains we've seen, the chief executive promotes collaboration and performance improvement with missionary zeal. The CEO of an apparel company, for example, would always make a point, during store visits, of asking shop floor staff how its recent commercial decisions had affected store operations, including logistics. He would bring up this feedback in meetings with purchasing and supply chain teams and continually encouraged his managers to follow up themselves and engage with shop floor staff on similar topics.

CEOs looking to get started can benefit from asking themselves five questions, which in our experience can help leaders begin to ferret out situations where faulty collaboration may be preventing supply chains from reaching their full potential.

Is production capacity being developed in the right locations -- both for today and the future?
Is the sales group doing all it can to make demand smooth and predictable?
Are customers offered the service levels they really need?
Is my marketing department calling for too many niche products that may be too costly to supply?
Are our purchasing and sourcing decisions being made with their supply chain implications in mind?
Poor collaboration and silo thinking have long thwarted the efforts of companies to get more from their supply chains. In a future characterized by rising complexity and uncertainty, solving this perennial problem will change from a valuable performance enhancer to a competitive necessity.

For more on how executives manage supply chain trade-offs, see "The challenges ahead for supply chains: McKinsey Global Survey results," on mckinseyquarterly.com.

Footnotes

1 Stock-keeping units.

PHOTO (COLOR)

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