

Focus Magazine  
January 2009

## Getting your supply chain into shape

**Like an economic ebb tide, the current recession has exposed many business's inefficient supply chains, according to Andy Keith, partner at Total Logistics, the specialist consultancy. Here he highlights the key areas where companies could reduce costs and improve their competitive position this year.**

Economic conditions have conspired to create a period of unprecedented uncertainty. Falling demand for products, unpredictable oil prices and financial liquidity issues are just some of the challenges that management teams are probably facing for the first time. Businesses need to make adjustments now to stay afloat and retain their core skilled labour, while not cutting back too much to ensure they are ready to grow when confidence does begin to seep back into the global economy. Clearly, supply chain managers play a significant role in driving out inefficiencies and freeing up valuable capital. Often seen as the 'backroom boys' of a business, many supply chain manager now have the potential to make or break the future of their businesses.

Our experience with a wide range of businesses involved in manufacturing, retail, FMCG, pharmaceuticals and fashion, to name a few, shows that most companies still have room to improve their supply chain cost base. Our belief is that by undertaking some fairly fundamental measures to review and re-engineer their supply chains, most businesses can quickly achieve significant cost reductions, without any great risk to their ongoing business processes, cashflow position or reputation.

### **Inventory management - making best use of what you have**

In our experience, most businesses play a sophisticated 'ostrich' game when it comes to the often emotive topic of inventory management. Because inventory ties up working capital, it is coming under critical focus this year.

Many organisations do not actually know the true cost of holding inventory, preferring to list it under working capital, without taking a closer look at the true cost of poor stock holding processes. This includes lost sales, excess warehousing, handling charges and write-downs.

Management of inventory is key to supporting sales and to managing the business within appropriate financial limits.

As a first step, businesses need to review their inventory planning and buying system parameters, as these can become out of date quickly, leading to a dislocation between the processes and the reality. Often, we see problems arising from legacy parameters, such as figures for supplier lead times and ordering quantities, not being changed in line with revised working arrangements.

Without updating this key information, all other reports and alerts created by the system become irrelevant.

One word of warning - updating all ordering parameters simultaneously will probably trigger a short term rise in inventory, due to shortfalls being made good, before excess stock sweats out of the network. It is therefore important to understand (by simulation) the phasing of changes that are made and to manage the pace of change within the budgets and network capacity available.

It has been widely written that accelerated product life cycles add to stock management challenges. The well known example of a flat screen television that faces the pressure of becoming obsolete if not sold quickly enough is a scenario that many more companies find themselves in compared to a decade ago. Certainly in fast moving and competitive retail markets, the trend towards price deflation makes smart inventory management a pre-requisite to success.

This point also links into the issue of sourcing from regions such as the Far East and the quantities of stock arriving from these destinations. Many importers should be asking themselves if it's yet time to source products closer to home markets on shorter lead times, given the full supply chain costs of shipping and storage. At least, they should be reviewing the volume of product being shipped in from far off locations and asking if these volumes can be reduced?

For instance, clothing manufacturers have reduced their risk in the area by sourcing the majority of stock from the Far East, while using suppliers based closer to home to satisfy the additional demand. This is a well tested supply chain model that reduces cost, but retains the flexibility to enable manufacturers to react quickly to unexpected spikes in demand.

Alternatively, Far Eastern supply chain models should be explored. There are now several good examples of companies using Far East warehousing to store product and then feed consolidated containers into Europe. This structure enables improved supplier management and terms, and good supply chain practices to reduce inventory and stockholding cost.

Another issue to address under the heading of 'inventory' is warehouse capacity, Good supply chain practice should reverse the recent trend for ever larger warehouses. Where a 'shed' has almost become 500,000 sq ft as the norm in recent years, there is now a lot of availability in large buildings that are unlet.

### **The big black hole of transport**

It might shock many logistics managers that recent research suggests that as many as 65 per cent of business are paying 15 per cent over the current market rate for their transport provision from 3PLs. And while there is little businesses can do to reduce this figure in the short term, this fact suggests that too few users of third party logistics providers undertake meaningful benchmarking to assess the relative cost of transport.

Clearly, operating a comprehensive tender process that is professionally managed and engages the market seriously is at the centre of the process.

While there may be little room for negotiation for businesses that have just embarked on a three year fixed contract, it is important to note that agreed breaks within that time for renegotiation linked to performance is a must for companies. This mechanism should also include an agreed way to deal with fuel price fluctuations as well as other issues such as health and safety performance and gainshare mechanisms where appropriate.

With job losses in the logistics sector already a reality, it's likely that capacity may come out of the market, which should create opportunities for businesses to take a fresh look at transport provision.

Another area that is often overlooked by companies is their network strategy. All too often, businesses operate to a tried and tested logistics map – typically an infrastructure of depots and routes to customer sites – that has not changed for years. We have found that by reviewing these networks, we can save companies tens of thousands of pounds per month by simply taking a fresh look at the location of their key customers and how they satisfy their demands. Inevitably, customers move location and their order profile changes. Our experience shows that often these changes are rarely reflected in an evolving supply chain network.

Likewise, decisions on customer allocation – distribution centres that serve specific customers – often create unnecessary supply chain inefficiencies. We recently undertook a review for a packaging company that operated two plants, both manufacturing the same products, located in the north of England and Wales. During our network review, we noticed that several customers based in Scotland and Yorkshire were still being serviced via the Welsh plant, due to sound historic reasons. By raising this issue and swapping allocation to the nearer plant, we were able to reduce costs significantly.

Similarly, we recently undertook a network review for a drinks manufacturer in Continental Europe. As their typical drop size is relatively small, this business operates with a fairly dense network of depots across the country.

While the company had sensibly allocated customers to their nearest depots in a bid to achieve efficiencies, real life can throw up some interesting anomalies. While this approach made sense on paper, in reality, the effect of increased congestion that a major city had on the model had not been considered. So, in reality, it made sense to reassign many more drops from the distribution centre that was located on the quieter side of the city, which dramatically improved delivery times and reduced costs. Clearly, this opportunist style of review works well in markets where opening and closing depots does not incur major cost.

We are also seeing many companies still using expensive express and air freight providers to mop up when poor supply chain planning comes creates uncertainty and low reliability.

We recently saw a major clothing retailer that was continuing to air freight up to 80 per cent of its product, citing the ever changing fashion market as the rationale for this high cost strategy. While it might be important to certain niche markets to stay that close to emerging trends, there is still no reason why a proportion of this huge transport cost could not be offset by employing sea freight to move less time-critical product lines.

Often, without clear information on the actual cost of transport, otherwise unacceptably high logistics costs continue to erode company profits. In our view, supply chain costs should be on everyone's agenda, not just the logistics managers'. Buyers and planners must be fully aware of the true cost of using airfreight on an item by item basis to lead to a change of behaviour.

### **What a waste - warehousing**

Outside overflow warehousing and the associated transfer cost is one cost area that can be rapidly addressed. It's a well documented fact that up to 30 per cent of space in an average warehouse is storing fresh air or unwanted products. By increasing space efficiency, stock can be brought back in-house.

Many businesses turn a blind eye to obsolete products and excess stock and marketing material.. Following an initial stock disposal, an annual budget is required for stock write-down.

We recently completed a project for a book publisher, where we increased space utilisation by around 20 per cent. This was achieved by employing an allocation model to identify opportunities based on such parameters as book size, popularity, predicted demand and longevity.

The area of handling, ergonomics and good old fashioned time/distance studies is another area of warehousing that often benefits from a spring clean. Getting the basics of the warehouse layout right is critical to reducing costs and ensuring your picking and packing operation is as efficient as possible. In our experience, simple layout and process “quick wins” can contribute significant productivity improvements.

Many might think that these suggestions are simply tinkering at the fringes of much bigger issues, but our experience shows that reviewing the area of transport alone can reduce overall supply chain costs by as much as £200,000 to £300,000 per year, with similar benefits being available in warehousing operations.

It goes without saying that in today's tough economic climate, where every penny counts, that kind of saving is not to be taken lightly. While none of these suggested supply chain reviews are pushing the boundaries of current logistics thinking, their adoption could mean the difference between survival and failure over the next year.