

SEVEN PRINCIPLES OF SUPPLY CHAIN

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Supply chain professionals today, increasingly find themselves assigned the role of the rope in a very real tug of war—pulled one way by customers' mounting demands and the opposite way by the company's need for growth and profitability. Many have discovered that they can keep the rope from snapping and, in fact, achieve profitable growth by treating supply chain management as a strategic variable.

These savvy managers recognize two important things:

1. They think about the supply chain as a whole—all the links involved in managing the flow of products, services, and information from their suppliers' suppliers to their customers' customers (that is, channel customers, such as distributors and retailers).
2. They pursue tangible outcomes—focused on revenue growth, asset utilization, and cost.

Rejecting the traditional view of a company and its component parts as distinct functional entities, these managers realize that the real measure of success is how well activities coordinate across the supply chain to create value for customers, while increasing the profitability of every link in the chain.

The initiatives to improve supply chain management by manufacturers, distributors, and retailers shows many making great progress, while others fail dismally. The successful initiatives that have contributed to profitable growth share several themes. They are typically broad efforts, combining both strategic and tactical change. They also reflect a holistic approach, viewing the supply chain from end to end and orchestrating efforts so that the whole improvement achieved—in revenue, costs, and asset utilization—is greater than the sum of its parts. Unsuccessful efforts likewise have a consistent profile. They tend to be functionally defined and narrowly focused, and they lack sustaining infrastructure. Uncoordinated change activity erupts in every department and function and puts the company in grave danger of “dying the death of a thousand initiatives.” The source of failure is seldom management's difficulty identifying what needs fixing. The issue is determining how to develop and execute a supply chain transformation plan that can move multiple, complex operating entities (both internal and external) in the same direction.

To help managers decide how to proceed, following are the seven fundamental principles of supply chain management.

The 7 Principles of Supply Chain Management

- **Principle 1:** Segment customers based on the service needs of distinct groups and adapt the supply chain to serve these segments profitably.
- **Principle 2:** Customize the logistics network to the service requirements and profitability of customer segments.
- **Principle 3:** Listen to market signals and align demand planning accordingly across the supply chain, ensuring consistent forecasts and optimal resource allocation.
- **Principle 4:** Differentiate product closer to the customer and speed conversion across the supply chain.
- **Principle 5:** Manage sources of supply strategically to reduce the total cost of owning materials and services.
- **Principle 6:** Develop a supply chain-wide technology strategy that supports multiple levels of decision making and gives a clear view of the flow of products, services, and information.
- **Principle 7:** Adopt channel-spanning performance measures to gauge collective success in reaching the end-user effectively and efficiently.

Translating Principles into Practice

Companies that have achieved excellence in supply chain management tend to approach implementation of the guiding principles with three precepts in mind:

Orchestrate improvement efforts

The complexity of the supply chain can make it difficult to envision the whole, from end to end. But successful supply chain managers realize the need to invest time and effort up front in developing this total perspective and using it to inform a blueprint for change that maps linkages among initiatives and a well-thought-out implementation sequence. This blueprint also must coordinate the change initiatives with ongoing day-to-day operations and must cross company boundaries.

The blueprint requires rigorous assessment of the entire supply chain—from supplier relationships to internal operations to the marketplace, including customers, competitors, and the industry as a whole. Current practices must be ruthlessly weighed against best practices to determine the size of the gap to close. Thorough cost/benefit analysis lays the essential foundation for prioritizing and sequencing initiatives, establishing capital and people requirements, and getting a complete financial picture of the company's supply chain—before, during, and after implementation.

A critical step in the process is setting explicit outcome targets for revenue growth, asset utilization, and cost reduction. (See Exhibit below.) While traditional goals for costs and assets, especially goals for working capital, remain essential to success, revenue growth targets may ultimately be even more important. Initiatives intended only to cut costs and improve asset utilization have limited success structuring sustainable win-win relationships among trading partners.

Emphasizing revenue growth can significantly increase the odds that a supply chain strategy will create, rather than destroy, value.

EXHIBIT 5

Relationship Between Supply Chain Principles and Financial Outcomes

Seven Principles	Revenue Growth	Asset Utilization	Cost Reduction
1. Segment Customer Based on Needs	●	◐	◑
2. Customize Logistics Network	◐	●	◑
3. Listen to Market Signals And Plan Accordingly	○	●	◐
4. Differentiate Products Closer to Customers	○	◐	●
5. Source Strategically	○	◐	●
6. Develop Supply Chain Technology Strategy*	◐	●	◐
7. Adopt Channel-Spanning Measures	●	●	●

● High ◐ Medium ○ Low

* Information technology provides the infrastructure required to capture benefits across the supply chain

Source: Andersen Consulting

Remember that Rome wasn't built in a day

As this list of tasks may suggest, significant enhancement of supply chain management is a massive undertaking with profound financial impact on both the balance sheet and the income statement. Because this effort will not pay off overnight, management must carefully balance its long-term promise against more immediate business needs.

Advance planning is again key. Before designing specific initiatives, successful companies typically develop a plan that specifies funding, leadership, and expected financial results. This plan helps to forestall conflicts over priorities and keeps management focused and committed to realizing the benefits.

Recognize the difficulty of change

Most corporate change programs do a much better job of designing new operating processes and technology tools than of fostering appropriate attitudes and behaviors in the people who are essential to making the change program work. People resist change, especially in companies with a history of "change-of-the-month" programs. People in any organization have trouble coping with the uncertainty of change, especially the real possibility that their skills will not fit the new environment.

Implementing the seven principles of supply chain management will mean significant change for most companies. The best prescription for ensuring success and minimizing resistance is extensive, visible participation and communication by senior executives. This means championing the cause and removing the managerial obstacles that typically present the greatest barriers to success, while linking change with overall business strategy.

Many progressive companies have realized that the traditionally fragmented responsibility for managing supply chain activities will no longer do. Some have even elevated supply chain management to a strategic position and established a senior executive position such as vice president-supply chain (or the equivalent) reporting directly to the COO or CEO. This role ignores traditional product, functional, and geographic boundaries that can interfere with delivering to customers what they want, when and where they want it.

Reaping the Rewards

The companies have enhanced both customer satisfaction and profitability by strengthening management of the supply chain. While the companies have pursued various initiatives, all have realized the need to integrate activities across the supply chain. Doing so has improved asset utilization, reduced cost, and created price advantages that help attract and retain customers—and thus enhance revenue.