Supply-Chain Survey

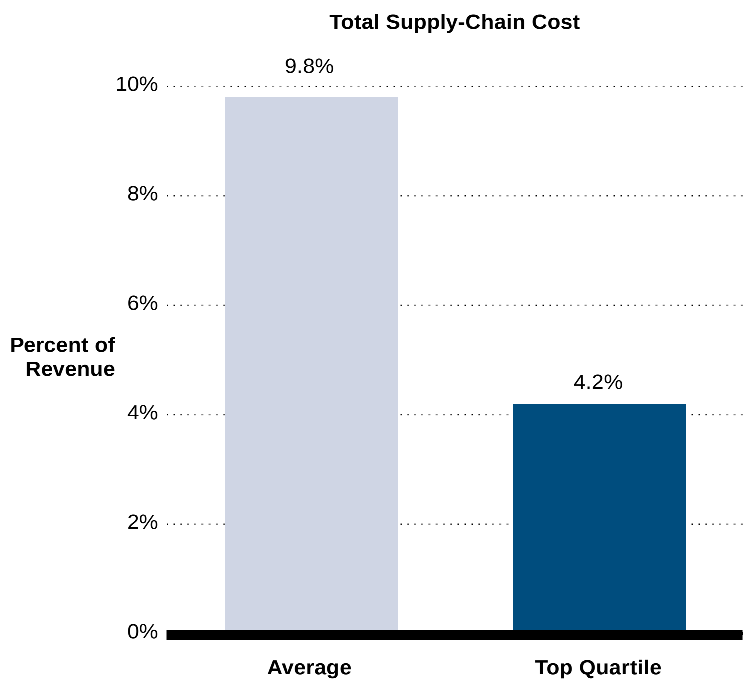
By Miles Cook

Where Supply-Chain Managers Go Wrong

When it comes to managing their supplies and inventories, businesses are staring at a huge cost sink. Research reveals that most are running their supply chains only *half* as efficiently as the top supply-chain performers—companies such as Toyota, Dell, and Home Depot.

One study shows that those top-quartile performers are spending just 4.2% of revenue on supply-chain costs compared to almost 10% for average performers in the same industry. ***(Figure 1)*** If all companies managed their supply chains as well as their best competitors, they would aggregate hundreds of billions of dollars of value for their shareholders.

***Figure 1*: The "average" spend twice as much as the "best"**



Source: PMG's 1999-2000 Supply-Chain Management Benchmarking Series

Miles Cook, based in Bain's Atlanta office, is co-director of Bain & Company's Supply-Chain Management practice.

The consequences of supply-chain problems are formidable. Independent research on the performance of 861 public companies showed that once a supply-chain malfunction is announced, stock prices drop as much as 12% irrespective of who was at fault—the company, its suppliers or even its customers. The personal consequences aren't pretty either. In the spring of 2000, after technology glitches at Hershey Foods kept its Twizzlers, Kisses and other confections off shelves the previous Halloween, the board of directors slashed top officers' bonuses.

The two-times cost gap is huge, especially considering that managers are attuned to the potential benefits of good supply-chain management. When Bain & Company polled 300 supply-chain executives—mostly heads of manufacturing, purchasing, and distribution in retail, automotive, and technology industries in the U.S. and Germany—it found that they rate supply-chain management as a priority (68% said so).

Fewer than 25% of those questioned hooked incentives to supply-chain performance; of those who did, almost all used only a few metrics, all of them inside their companies' four walls.

At first glance, it's hard to say why the differential is so wide. Powerful and sophisticated software has been available for some time now; in fact, these days supply-chain management software gets one in five dollars spent on technology, and constitutes a $6.7 billion-a-year industry growing at 32% annually, according to market-analysis firm AMR Research. Also, there's a sizeable body of knowledge around the practice of supply-chain management; and businesses have had ample experience with outsourcing—and plenty of time to get used to their roles in supply "networks." But further polling begins to uncover some disturbing patterns that explain the gap and offer clues to how to close it.

What's perhaps most disturbing is that so many senior managers believe they're doing a great job with their supply chains. More than 40% of those polled by Bain felt that they outperformed the competition in terms of service, cost, and asset utilization. ***(Figure 2)*** What's happening here?

One explanation may lie in the conclusions from ***Figure 3.*** Only 25% have what they would describe as full information on their supply chains; nearly 45% of respondents admit to having little or only basic data. Ignorance should not be bliss when it comes to supply-chain efficiencies. In a separate finding, there is evidence that managers are reactive when it comes to the big picture. They are alert to the needs for accurate production planning and on-time parts-delivery forecasts. But, in a separate survey by the Compass & Garfield School of Management, less than half (45%) of the managers queried said they had "most elements" of a supply-chain strategy.

Figure 2: **Many think they're supply-chain wunderkinder**

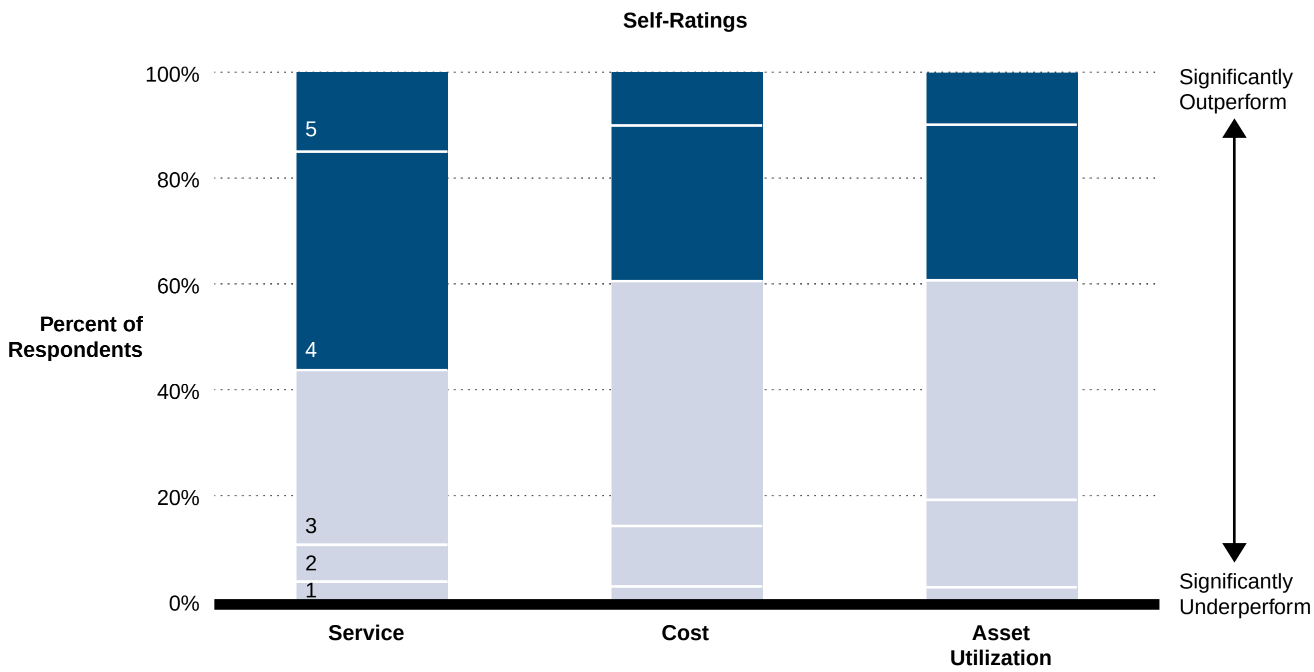
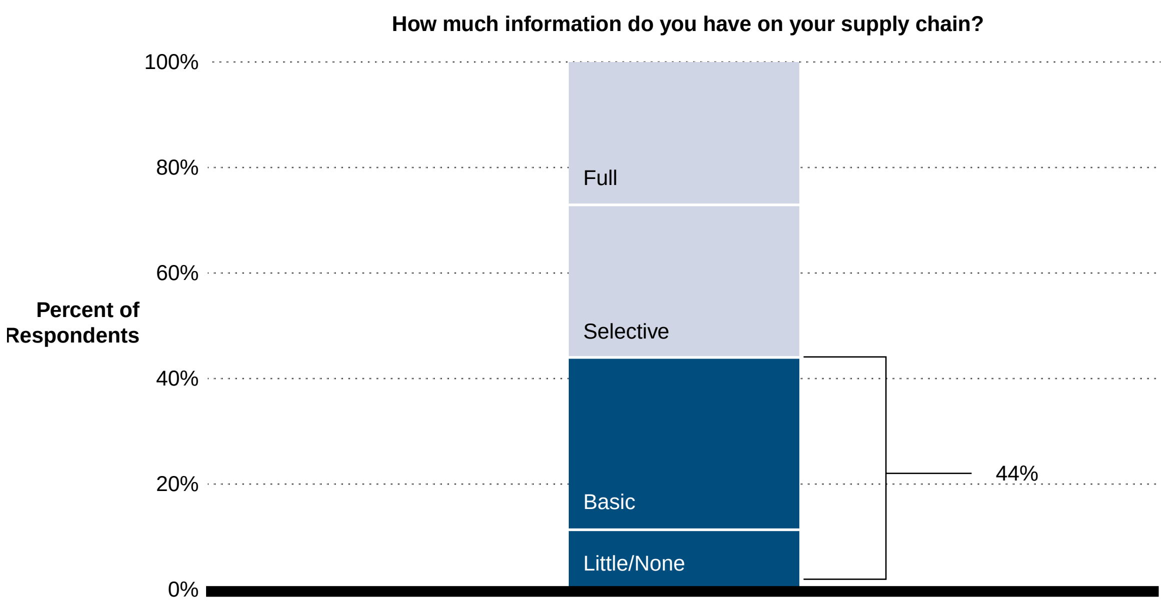


Figure 3: **Few have good information on their supply chains**



Bain pinpoints another reason for the performance gap: an introverted approach to supply-chain management. What do we mean by that? Simply put, too many companies focus their supply-chain initiatives within their own four walls. They work to squeeze down in-house inventory, or streamline the forecast processes without recognizing that the supply chain extends forward to customers, and back, to suppliers and *their* suppliers. Imagine how difficult it is for a supplier to plan production effectively if its customer is stingy with forecast data.

By contrast, the benefits of "opening up" are many. Dell Computer has one of the most "transparent" supply chains anywhere, and that transparency came in handy a few years ago when Dell noticed that its customers were ordering PCs with much larger hard drives. The PC maker quickly called its key supplier and began buying the big two-gigabyte drives. Meanwhile, the supplier found a home for the now-marked-down one-gig drives: a Dell

Untangling Your Supply Chain

The top performers stick to six key principles:

1. Straighten Out The Strategy First. Too many companies see salvation in technology. One study says three of the top four drivers of supply-chain excellence are not related to technology, but to alignment of organization and to performance measurement. Defer IT spending decisions until key strategy elements are in place.

2. Enlist The A-Players. The supply-chain leaders hire the very best strategists, the best purchasing experts, the best logistics pros—and get them to work together under a top executive whose mandate is supply-chain excellence.

3. Align The Incentives Correctly. People do what they're paid to do. Tie incentives to the big goals: hook transportation managers' pay to on-time performance *and* trucking costs, supply-chain executives to ROA *and* vendor metrics. Reward for cross-functional collaboration too.

4. Replace Rules of Thumb with Metrics. Don't measure, can't improve. Get the data on everything from vendor delivery performance to forecast accuracy; determine which metrics matter most. Measure the "what ifs" and track your entire supply chain—not just what happens inside your business.

5. Work Beyond Your Four Walls. Practice enlightened self-interest: share forecast and other data with suppliers, and demand the same of your customers. "Organized interdependence" is the goal. To reach it, offer trust and ask for reciprocity—and work to improve your communications channels.

6. Avoid "One Size Fits All" Solutions. Excellent supply-chain management means juggling multiple supply chains simultaneously. Top performers differentiate by product, by channel, by customer.

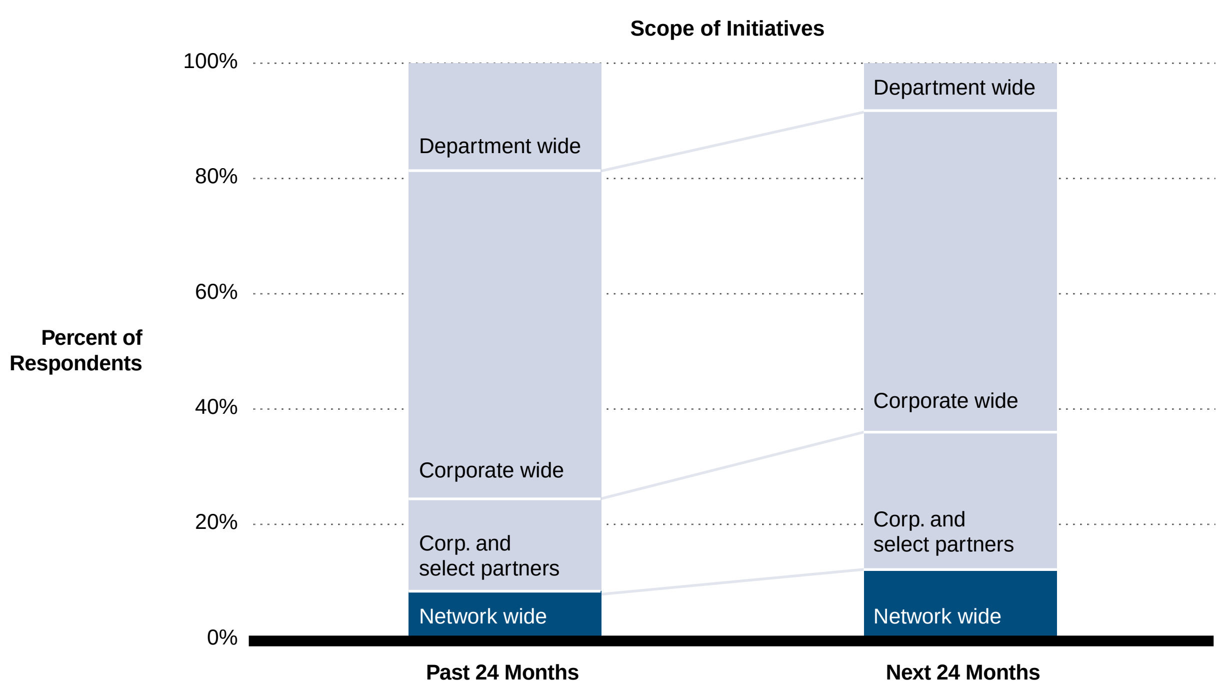
competitor. But that competitor was using opaque six-week forecasts, and did not foresee the bottom falling out of the market for PCs with the smaller drives. It had to take a large write-down, and suffer a loss of market share.

We can monitor the "introvert effect" in several ways. Our survey reveals that only 15% of supply-chain initiatives have an end-to-end "network" reach. ***(Figure 4)*** Of the three vertical industry sectors we surveyed, none had impressive levels of data-sharing across the extended supply chain. Indeed, more than half failed to collaborate outside the company on critical areas such as demand and production planning.

On-time delivery is tracked by 85% of our survey respondents, logistics and distribution costs are followed by 75%, but only 39% chart cash-to-cash cycle time.

The supply-chain experts—companies such as Ford Motor Co.—recognize the need for interdependence. If Ford had not built solid links to both suppliers and customers, it would not have been able to handle last year's recall of Firestone tires as effectively and efficiently as it did. And later, it might not have been possible to so quickly offer customers and dealers their choice of tire brands on Ford's new Explorer models.

***Figure 4*:** **Supply-chain initatives don't reach far enough**



Supply-chain leaders like Ford see beyond the supply chain to a supply "network" or "ecosystem" in which the actions of each member have a direct bearing on every other member. A case in point: a third-party provider of customs-clearance services might not enjoy the same status as a vendor of a critical component, but consider its significance if a just-in-time delivery is held up.

The research digs up two other key factors: the scarcity of incentives to change behavior, and the paucity of measurements to gauge supply-chain performance. Fewer than 25% of those questioned hooked incentives to supply-chain performance; of those who did, almost all used only a few metrics, all of them inside their companies' four walls. ***(Figure 5)*** Bain often finds that the wrong goals are in place—or no goals at all. For example, we've come across transportation managers who are compensated for trucking costs but not for on-time deliveries, and senior supplier-chain managers who have no incentive to improve returns on assets.

The supply-chain champions focus on cross-functional collaboration between key functions such as purchasing and distribution. At one major electronics retailer, where line managers constantly interact across department boundaries, the logistics department is rewarded for serving merchandising well.

***Figure 5*:** **Fewer managers have incentives to make supply chains work better**

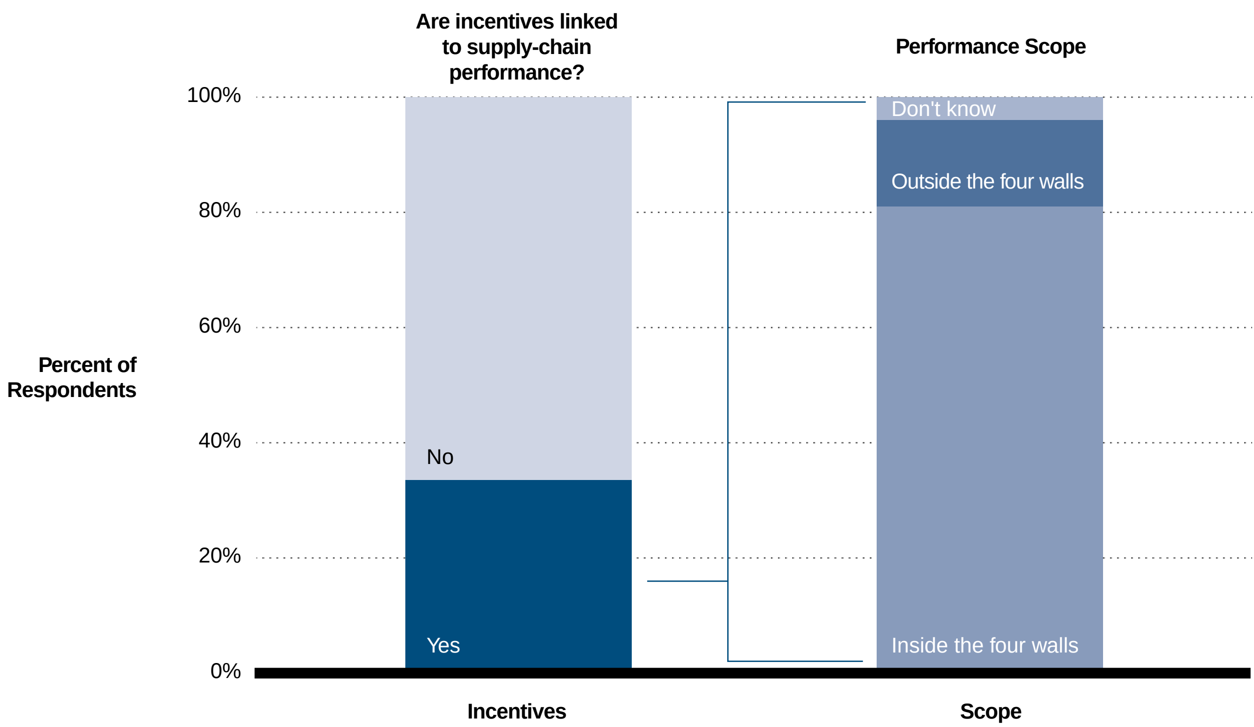
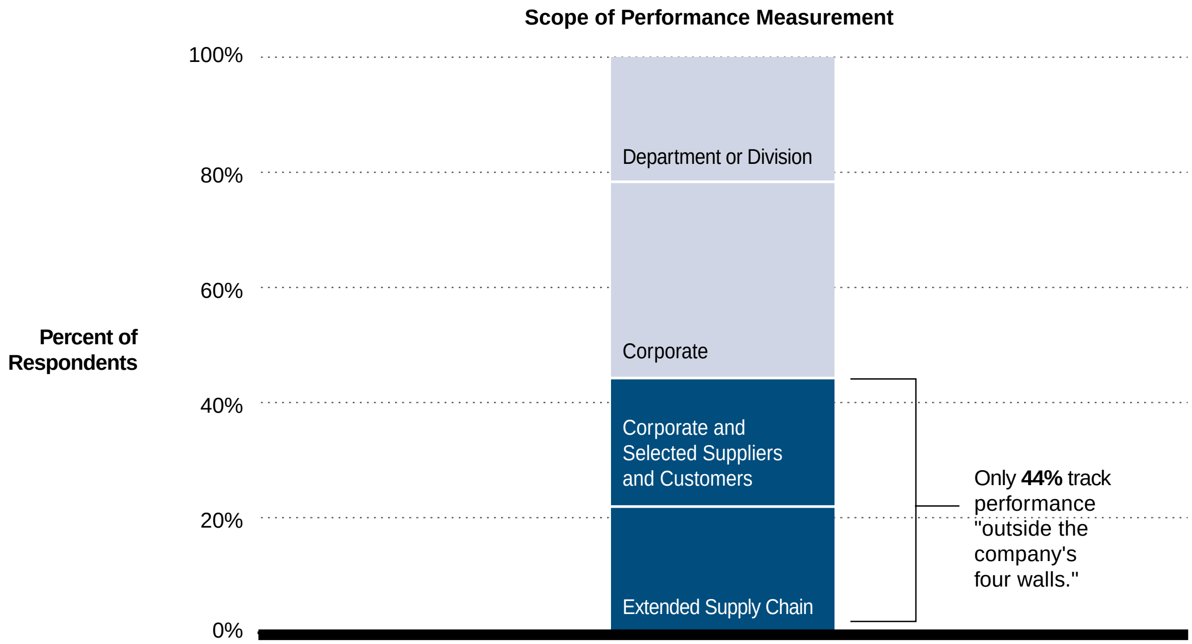


***Figure 6*: Few track supply-chain performance outside their organizations**



Metrics are the other weak spot of many supply-chain wannabes, and again, the bias is toward internal measurements rather than all across the supply chain. ***(Figure 6)*** Companies that do not measure performance are hard-pressed to say how much their supply-chain inefficiencies really cost. We know of one large retailer that focused on managing its vendors' gross margins—until new data proved that the vendors' substandard *delivery* performance compelled the retailer to keep an additional $200 million in inventory.

Supply-chain management has to run on data, not on instinct. That calls for continuous and rigorous analysis of everything from customer forecasts to product pricing to warehouse inventory turns.

So when companies do measure, what do they measure? On-time delivery is tracked by 85% of our survey respondents—the highest rate of 15 metrics we asked about. The least-measured: cash-to-cash cycle time, charted by 39% of supply-chain managers. Fifty-three percent log fixed asset turns; three-quarters follow logistics and distribution costs.

What hope is there that supply-chain practice will improve? For a start, all the companies in the Bain survey said they intended to increase their external supply-chain activity over the next two years. But that's only a start. Many other companies can expect inventory or supplier trouble as performance pressures grow and software becomes more complex. The businesses that we predict will take the biggest hits? Those that reflexively commit to technology purchases before they've developed holistic strategies for managing their supply-chain networks.

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BAIN & COMPANY, INC.
Two Copley Place
Boston, Massachusetts 02116
1 617 572 2000