Charting a new course in effective distribution supply chain management

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Executive overview

Supply Chain Management (SCM) is back with a vengeance for distributors operating today. And, while the primary reasons for pursuing supply chain effectiveness continue to be lowered operating costs, improved customer service and increased profitability, the complexities and challenges within today's marketplace have dramatically altered the strategies needed to achieve it. Today's supply chains require completely different approaches to address these changing market conditions; and distributors who fail to recognize this may not survive into the next decade.

Multiple forces are pushing supply chain effectiveness to the top of the priority list for wholesale distribution. On the demand side, manufacturers are moving factories to low-cost labor countries, forcing distributors to follow and pushing already inefficient supply chain infrastructures to the breaking point. Manufacturers also are driving in the direction of build-to-order or lean systems, requiring distributors to meet increasingly short leadtimes and achieve perfect on-time delivery performance. Without proper attention to supply chain effectiveness, those performance improvements can only come at the expense of the distributor's bottom line.

Retailers have likewise been relentlessly pushing up performance requirements for distributors. Web-based electronic commerce systems have brought new market entrants plus more direct selling and coopetition from distributors' traditional suppliers. All this has occurred against a backdrop of aggressive 'cost-down' sourcing, supply-base rationalization, and supplier performance management by procurement organizations at the distributors' retail and manufacturing customers.

Distributors have compounded these demand-side forces by focusing intensely on top-line growth – whether by acquisition, expansion into new geographies, adding new suppliers, creating new product lines, or making aggressive commitments to customers on price, leadtimes, on-time delivery, inventory levels, or payment terms. The outcome is that many wholesale distributors are now pursuing top-line growth at the expense of bottom-line profitability.

Financial analysis of the distribution industry shows that businesses are stretched so far that for the average $100 million wholesaler, pursuing one additional percentage point of revenue growth would generate negative six percent in cash flow, whereas pursuing an additional percentage point in total operating expense improvement or days in inventory would generate an additional $250,000 in revenue.

To reverse this dangerous trend, it's imperative that wholesale distributors quickly chart a new course to supply chain effectiveness. They must regain control of their operations and match their investment with their demand levels to ensure profitability.

Changing distribution market dynamics

Today's wholesale distributors — regardless of size — are often finding themselves interacting with many more trading partners across multiple time zones, languages, transportation modes, types of facilities, and types of business relationships. Global supply channels and offshore manufacturing are now more and more commonplace. What once sufficed for supply chain optimization is now just "a license to drive." In the emerging economic model, true competitiveness comes from tight integration among trading partners and sophisticated information management among all nodes in the supply network.

To formulate long-term business strategies that balance top-line growth with bottom-line profitability in a dynamic market environment, distributors should be asking these questions:

- How can we continue to add top-line growth while remaining flexible and able to react to change?
- How do we reduce the risk of doing business internationally while capturing the economies and efficiencies of scale? Where is the risk? Where is the variability?
- Where are the synergies with the new areas -- geographic, supplier-related, or new categories of inventory -- that we are moving into?
- How can we maintain margin and profitability to make that growth/expansion pay off? What are the costs of that growth and how can I manage them to remain in line with that top line?

Growth=profitablility?

In the not-too-distant past, top-line revenue growth could be counted on to translate – more or less directly – into greater profits for distributors. But aggressive growth strategies of the past few years have resulted in distributors:

- Carrying substantially higher inventories
- Carrying more diverse inventories
- Doing business with larger numbers of suppliers
- Doing business with larger numbers of customers
- Operating across multiple distribution tiers
- Operating across broad geographies that often span national borders, oceans, and time zones.

Given the overextended state of wholesale distributors' operations, it's now common for additional growth to be cash-flow negative. The complexity of increasingly global operations that carry uncertainty and inventory redundancies – while coordinating business among larger numbers of trading partners – is not efficient enough to scale with top-line revenue. This is a barrier common to most sectors in the distribution marketplace, and a barrier that threatens the sector's continued financial success.

The following table details some of the potential costs or cost risks that can arise when top-line growth strategies are executed without corresponding attention to supply chain effectiveness.

"Optimizing the supply chain is the key to fulfilling our global demand."

– Karl Angler,
Vice President of Finance
Stihl Inc.

Driving top-line growth from:	Can result in supply-chain complexity risks/costs from:
New/global geographies	▪ Longer leadtimes, requiring higher inventories ▪ Multiple languages, requiring translation ▪ Multiple time zones, requiring greater coordination ▪ Multiple legal, regulatory , and tax systems, requiring substantially more information/data management ▪ Higher total landed cost (transportation + product handling + logistics management + tax + costs associated with regulatory compliance) ▪ Increased cost/risk exposures from fuel price variability, transportation capacity constraints, and currency fluctuations
More locations/multi-tier	▪ Higher costs associated with broader management of inventory distribution networks product flows ▪ Greater complexity in making allocation and transfer decisions across locations (e.g., warehouse vs. cross-dock, central DC vs. regional DC, etc.)
Increased inventories/ greater inventory diversity	Costs associated with broader management for: ▪ Variable demand patterns ▪ Variable distribution/inventory velocities ▪ Variable sourcing time lines
More suppliers/dual supplier	▪ Higher costs for ordering, shipping, receiving, accounting, settling, strategies measuring and managing supplier performance ▪ Higher costs associated with multiple information systems/ translation requirements ▪ Higher costs associated with multiple communications modes (computer, phone, fax, paper, etc.) ▪ Higher costs associated with managing/translating among multiple communication standards/protocols (EDI, Web/XML, etc.) ▪ More spot buys and expedited shipments to fill supply gaps
More customers	All of the above, plus: ▪ Risk associated with dilution of service capabilities ▪ Greater difficulty/complexity/cost in seeing and aggregating customer demand ▪ More spot buys and expedited shipments to fill gaps in dem and visibility ▪ Difficulty/increased costs in maintaining competitive strengths and fight off threats from direct competitors and suppliers' direct sales
Acquisition	Higher costs associated with: ▪ Redundant locations ▪ Multiple business processes and information systems requiring integration ▪ Manual work resulting from lack of systems integration ▪ Functional and business-unit silos that require integration and greater communication ▪ Risks associated with unfilled holes in distribution network capabilities

Strategies for success

Optimizing a distribution business within the new, extended supply chain environment is clearly a serious undertaking. Distributor can no longer expect to follow a single, straightforward supply chain model. Today's model consists of multiple process flows – some needing optimization, others needing integration. And the model will change continually as suppliers, customers, outsourcing partners, locations and geographies drop in and out over time.

But even with such tough issues to plan around and a changing environment in which to execute, there are distributors achieving substantial success in supply chain optimization. They are succeeding because their leaders are willing to devote the time and planning energies needed to structure multiphase, long-term approaches that incorporate the following five strategies:

- Make a clear choice between top-line growth and profitability. Then put a sharpened focus on the financial metrics for the articulated choice. Top-line growth initiatives like acquisition, new inventories, or new geographies – whether technology-driven or not – have many systems implications for which distributors must plan. Meantime, profitability measures, for example, targeting day in inventory (DII), cost of goods sold (COGS), margin, or speed-to-market, tend to be more technology-driven themselves.
- Chose one entry point. Every journey begins with a single step. For example, a long-term strategy for reducing/optimizing inventories involves choosing a specific point of departure such as: demand visibility, supply chain execution, perpetual inventory visibility, process black holes where information disappears, etc. Each distributor has its own unique challenges that help to determine the best entry point.
- Limit the functional or operational scope targeted for improvement. Useful exercises for determining project scope include: charting future growth needs, identifying processes that will be affected, identifying data dependencies (both inbound and outbound), and isolating specific departments or categories for pilot and roll out.
- Track specific metrics. Outcomes will vary, so easily quantifiable metrics – like DII and COGS – must be balanced against other, less quantifiable results. Once scope is set, distributors must establish baselines for measuring success. Whether they be operational metrics (such as DII), people-related efficiencies, or regaining missed opportunities or service levels, the best measures for success chart effectiveness in the emerging supply chain management model.
- Focus on adjacent or related areas of impact to apply the model. As supply chain optimization initiatives move forward the next areas of value or opportunity often become apparent. Questions that can help identify those opportunities: Are there other departments with similar conditions? Are there up- or downstream operations that will have a similar impact on the same metric?

Putting strategies into action

The following case studies provide four specific examples of distributors who are addressing the complexities of the distribution marketplace and working with Infor solutions to execute objectives for supply chain effectiveness.

Case 1: Drive demand focus from planning through execution.
This distributor's defined objective is to improve buying effectiveness and accuracy through the life of its inventory -- a good entry point because it falls at the beginning of the inventory cycle.

At the outset, the initiative establishes buying levels by calculating the SKU/location end-demand forecast with the intent of improving buy accuracy and cutting significant inventory from the operation. Subsequent planned steps include: driving the demand forecast through allocation planning; reconciling incoming levels against distribution center capacity requirements and inventory histories and, eventually, applying the forecast to both labor and shipping requirements.

The initiative is projected to reduce total inventory in the supply chain by 13% with nearly half of the reduction resulting from initial improved buying.

Case 2: Link sourcing with distribution through optimized execution.
This initiative uses Infor's powerful visibility tools to take sourcing order activity, link it with shipment builds, active in-transit monitoring, and event management, and then drive the resulting inbound visibility through the distributor's multi-tier distribution network.

This type of initiative is very popular with forward-thinking distributors. The results are lower landed costs through efficient use of transportation, more reliable shipments, and capital cost avoidance as the distributor has been able to forego building an additional DC for cross-docking shipments.

Case 3: Maximize warehouse utilization.

In this case, the distributor has been through a few small acquisitions over the past two to three years. Prior to the acquisitions, the distributor had experienced constraints in its supply network; the acquisitions did not entirely alleviate the constraints and also created redundancies, leaving the distributor struggling to figure out which problem to fix first.

Their initiative was to deploy Infor tools to measure total inbound visibility and perpetual inventory within specific distribution centers and across its total distribution network. This will enable the distributor to balance activity with warehouse capabilities and route needs among them, making it easy to identify where capacity investments or divestitures are required.

Case 4: Collaborate with customers to develop potential Vendor-Managed Inventory (VMI) relationships.

This distributor – who sells to retailers – is facing new competition as a large new rival has entered the space. Their initiative uses Infor demand planning solutions to forecast end-consumer demand based on shipments to various retail locations. Demand forecasting helps the distributor improve inventory and account performance and also to offer a value-added service to key customers by sharing optimal suggested buying and replenishment data generated in the forecast.

Longer-term, as their retail customers get more comfortable sharing sales data by location, the accuracy of the distributor's demand forecasts will improve. The distributor's intent is to position itself competitively to achieve tight vendor managed inventory relationships with key retail accounts.

"I'm going to recommend that you invite your trading partners into your inner circle – tie to them electronically, work together to eliminate waste and duplication. The technology that we have today will help you get there."

– Steve Epner
Founder
Brown Smith Wallace
Consulting Group

Solutions rise to the challenge

Wholesale distributors that continue to pursue growth while neglecting supply chain effectiveness are putting their long-term survival at risk. As the saying goes, they may be “growing their way into bankruptcy.” And there’s no good reason for this. As the above examples demonstrate, the challenges in supply chain optimization are substantial, but certainly acheivable. And, while supply chains have gained complexity in recent years, the process and technology solutions for achieving effectiveness in supply chain management have gained sophistication and become both more accessible and easier to deploy.

With the largest distribution customer community in the industry relying on Infor for their business success, Infor delivers best-in class solutions to address the challenges in building effective supply chains. Over 5,000 distributors have chosen Infor to bring together their demand planning, customer account management, ecommerce, order transaction and management, enterprise purchasing, strategic sourcing, supply-chain management and after sales and service operations. As distributors look to build top-line growth along with supply-chain efficiencies, Infor can help them expand globally, improve inventory and asset performance, manage acquisitions and enrich their customer relationships.

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