When supply chains go bad!

12/Mar/2008

Very few manufacturers, retailers, or for that matter logistics providers, willingly reveal their distribution disasters. If case studies and conference presentations are to be believed all supply chain re-engineering projects are faultless, executed on time and to budget. However, of course, this is rarely the case.

Logistics only tends to hit the national and international headlines when things go wrong. In most cases supply chain problems remain closely guarded secrets with clients and suppliers highly sensitive to negative publicity. It is left to publicly listed companies, forced to release information on their performance to shareholders, to occasionally lift the lid on their supply chain challenges.

Of course there are varying degrees of seriousness, ranging from the sub-optimal implementation of a new strategy (which in itself can be highly damaging, such as in the consumer electronics sector as outlined below), right through to the downright disastrous.

Dell – migrating to a new supply chain model

Falling into the former category, computer giant Dell is presently undergoing quite considerable supply chain challenges. It is migrating from a direct-to-consumer retail model to one which involves a mix of direct and more traditional retailing channels. The company says that from a standing start it is now in 10,000 stores worldwide including in the US, Wal-Mart, Best Buy and Staples. This decision has involved a huge cultural change and one which has had what management hope is a temporary impact on performance.

In effect what Dell has done is to create a number of parallel supply chains, but with very different dynamics and the added complexities of working with a range of retail partners. This new retail model means that Dell will quickly have to get to grips with reduced inventory transparency, a problem that it didn't have when it was operating just its direct, 'pull' model.

This sort of systemic change is bound to create issues although Dell would argue that it was a necessary step to push back against vibrant competition from rivals such as HP, Apple and Lenovo. However the costs involved in moving to this new business model were a major cause for a dip in Dell's share price after its latest quarterly results.

Sainsbury's 'modernisation' goes backwards

J.Sainsbury, one of the largest retailers in Europe, provides another, more extreme, example of the critical nature of logistics to corporate success and failure. The retailer faced a financial crisis in 2004 which management partly blamed on its poor supply chain performance. Its disclosure to shareholders gave an insight into how failing logistics systems impacted on the whole company.

The Chief Executive, Justin King, blamed much of the problem on his predecessor for wasting billions of pounds on a new distribution strategy that affected sales and profits at Sainsbury's stores. The three year 'modernisation programme' entailed upgrading a significant proportion of IT systems, closing 15 older depots and transferring operations into seven new facilities as well as opening four automated depots.

However, management admitted that this initiative affected severely the availability of products on the shelves. It also acknowledged that developing a wide range of products designed to meet the needs of a multitude of consumer groups led to the development of an overly complex supply chain solution which could not be delivered to the required scale. Performance and costs were higher than before these initiatives were implemented.

On top of this, the new automated depots in which the company invested, failed to perform at planned levels. This resulted in a new management team being appointed and further changes being made. Distribution centres which had been slated to close, or had already been closed, were re-opened in order to ensure availability of product over the Christmas period and manual support was brought in where automated systems were failing. Suppliers were also targeted to ensure compliance with automated processes.

The failures not only impacted on the level of sales. The company was forced to write off £200m (€300m), £120m (€180m) related to automated equipment in the new fulfilment centres and £80m(€120m) related to the carrying value of stock due to a change in operational approach, disruption in new depot and IT implementation as well as accelerated clearance of excess general merchandise stocks.

Automotive sector not immune

For a sector renowned for the sophistication of its logistics, automotive manufacturers are not immune. In 2004 Caterpillar Logistics Services ('Cat Logistics'), the logistics subsidiary of the US multi-national, took over the spare parts business of now defunct UK car manufacturer, MG Rover. Cat Logistics had been handling MG Rover's parts business since 2002 from its Desford facility in the UK.

At the outset of the original ten-year contract there were significant problems, although the partnership proved strong enough to overcome them. These difficulties related to the transition from its former logistics supplier Unipart to the new provider largely caused by the loss of experienced and skilled employees prior to the hand over. The resulting bottleneck forced the shut down of production at MG Rover's plant to allow component manufacturers to drop-ship spares directly into the after market distribution network. At the same time Cat Logistics was forced to 'parachute' in skilled logistics specialists from other parts of its organisation to address the situation.

One the most 'sophisticated' automotive logistics failures must be that of the old supply chain and logistics system of Italian auto company FIAT. This was a superb concept, way ahead of the competition in managing both finished vehicle inventory and inbound parts flow. The only problem was that FIAT's management structure was at war with itself. The marketing department created sales incentives that led to dealerships filtering off cars to be sold on a grey market. The result was a huge stock of new cars being moved around Europe surreptitiously in order that dealerships could exploit the cash being offered by FIAT.

Extended supply chains create risk

Although there is no space in this article to explore in detail the increased level of supply chain risk caused by globalisation, one recent example of the impact of a supply chain re-engineering project which has impacted negatively on results is that of medical device manufacturer, Smiths Medical.

A relocation of plants from the UK and Germany to lower cost regions resulted in temporary supply disruption and sales declined by 1%, well short of market benchmarks. The major changes in the structure of the internal supply chain resulted in a faster utilisation of buffer stocks and a slower ramp up of production than was required to satisfy demand.

Of course, supply chain disasters do not just occur in the warehouse. Problems caused by disruption to shipping using the Suez Canal led to major supply chain problems for Sony in the run up to Christmas 2004. A tanker got stuck in the canal causing serious backlogs, resulting in a container ship carrying supplies of the market-leading game consol, Playstation 2, being delayed for two weeks.

Stocks in some parts of Europe ran out and Sony was forced to fly in supplies using chartered Antonov cargo planes at huge expense. Product changed hands on electronic auction sites at around four times its retail price.

Logistics – still not a corporate priority?

The cases outlined above demonstrate what an important factor logistics has become to the success, or otherwise, of the largest manufacturers and retailers. Despite this the function is still regarded by many as a poor relation in corporate management, a hangover from the time when high levels of inventory made inefficient supply chain practices less critical. Although this view is slowly changing, logistics has very little direct representation in company boardrooms, and its influence on corporate strategy is still limited.

Thomas Cullen, Ti's Senior Analyst, will be speaking on 'Getting supply chains right…and wrong' at Global Distribution Strategies Conference 2008, May 13-15, Marriott Hotel, Amsterdam. Follow the link for more information and to register.

Source: Transport Intelligence, March 12, 2008