WHITE PAPER

Releasing Supply Chain Value

Through better order management

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1.1 Introduction

When companies attempt to reduce their supply chain costs or improve their logistics efficiency they often only look at the rate structure and relationship with their third party logistics & warehouse providers. This neglects levers that exist within their own organisation that influence elements such as order size, value, and frequency that is shipped to customers. The reasons for not looking internally for opportunity are various: fear that changes in order policy might result in lower service levels; limited understanding of the current cost to serve (and therefore what benefits could be had by changing practices); or misconceptions on what is important to the customer (e.g. reliability versus frequency). With more channels to market and smaller order sizes becoming the norm, the supply chain cost to serve is increasing putting pressure on margins. Re-evaluating how companies manage orders can be an effective method to unlock value, continue to serve profitably and critically drive improvement with minimal investment.

The following white paper identifies key value levers that can be employed to reduce an organisation's cost to serve through better order management. These levers can be implemented before or separate to engaging freight or warehouse providers. Case studies show companies who have incorporated the identified recommendations have increased gross margin by up to 20%. Optimising order management improved one client's transport costs by ~15% before rate renegotiation whilst opportunities of $4.5M were identified at another client on a logistics expenditure of $19.7M. Improvement areas span across the organisation ranging from customer sales (ordering, invoicing) and warehouse (picking, packing, processing) to transport (assets, schedule, routings), and system automation (trading terms, discounts). Although changes are often within the supply chain function's remit, it is critical that the broader business is engaged in solution development to identify and mitigate risks and create an effective communications plan to convey to the customer.

"Case studies show companies who have incorporated the identified recommendations have increased gross margin by up to 20%"

1.2 The Situation & Consequences

Supply chain managers are commonly faced with challenges in delivering products to customers in an efficient and cost effective manner. New circumstances have arisen as a result of today's business environment which make this task even more difficult to achieve. The consequences of not responding adequately to both the traditional and new challenges of the current operating environment are increased operational inefficiency resulting in higher cost to serve and reduced profitability. Examples of traditional order challenges:

- Customer Service Agreements

  – Standard service levels are not defined leading to variations in commitments and poorly managed expectations

  – Agreements do not reflect supply chain capability leading to poor customer satisfaction and performance penalties (e.g. a sales team might allow an order cut-off time which is too late to be effectively processed for on time delivery)

  – Lack of clarity on special (e.g. rush) order costs resulting in excessive use (become norm)

  – Business contracts do not incentivise customers to improve order efficiency (e.g. informal ordering practices are allowed without penalty, financial incentives are not offered to encourage better order practice, orders might be split at a customer end due to different rebate structures for different categories) Ordering Processes and Systems

  – Minimum order quantities (MOQ's) are frequently not established, determined incorrectly versus theory (e.g. the minimum order quantity is set by order value as opposed to margin) or not applied

  – Order lots sizes are not configured based on warehouse and transport efficiency (e.g. pallet or layer quantities)

  – Companies often have no standard ordering policy to handle sub-optimal or unplanned orders (e.g. product quantity constitutes a pallet and a case) and even when they do exist, systems are not setup to flag non-standard/non-optimised orders and apply proper costing

  – Supply chain systems are often not able to model the potential for alternative logistics models (e.g. direct order delivery to customers from factories) or dynamically route orders to optimise deliveries

- Business Order Reporting

  – There are limited key performance indicators tracking order management performance (e.g. % of special orders or % of order lines in each case/layer/pallet, warehouse cost per pick, cost per drop)

  – Cost reporting in a business is often not granular enough to be able to understand the true cost to serve

  – this is critical to understand a margin value by customer

In addition to the traditional challenges the following highlight examples of "new" challenges that further emphasise the importance of robust order management:

- New Service Environment

  – Customers increasingly require lower volume, more frequent drops to reduce their working capital while wanting to maintain their service level targets. This often results in multiple drops for out-of stock items and costly expedition to avoid penalties

– The promotional environment drives extreme demand patterns which require special ordering approaches. Often companies have a one size fits all approach to determining drop frequency and order size which does not vary based on these changes in demand

– The increased competitive environment and change in consumer behaviour is changing delivery requirements. In the consumer goods retail space, the "milk wars" and growth of metro stores are decimating mom and pop store volume and reducing route trade business for suppliers

– Increase cost of rent, making stores (and therefore storage areas) smaller and further impacting ability to hold product

– Increased competition has led to companies developing more niche SKU's and filling their new product introduction pipeline. SKU proliferation both increases forecast difficulties and increases order picking and delivery complexity

- New Business Channels and Operating Models

  – The Internet age has added a new source of delivery complexity as well as a requirement for a different type of order picking (e.g. single units versus layers). This has a further impact on the retail environment which was already struggling from lower sales

  – Customers are increasingly looking to extract value outside of their own 4 walls (often at the supplier's expense). Collaborative programs that release value across customer supply chains are increasingly common. Major retailers are conducting primary freight activities or requiring delivery into central distribution centres reducing delivery efficiency for remaining customers

"Often companies have a one size fits all approach to determining drop frequency and order size which does not vary based on changes in demand"

The consequences of the above challenges span across the organisation - destroying efficiency, increasing cost to serve and reducing profitability:

- Customer Service Inefficiency

  – Average value per order decreases while cost per order often remains constant

  – Inflated number of orders (special orders not managed, no MOQs and delivery frequency not controlled)

  – Ordering mechanisms remain manually intensive (e.g. fax, phone)

  – Increased amount of invoice processing

- Warehouse Inefficiency

  – Inflated number of orders (as above) increase processing and order fulfilment costs as average value per pick is lower

  – Picking efficiency is driven down by sub-optimal order lot sizing

- Transport Inefficiency

  – High special order delivery costs (priority freight)

  – Lower value per drop from inflated number of drops and lack of MOQs

  – Poor vehicle utilisation (poor/ no alignment on delivery schedules and geography)

  – Low/no recovery of freight

1.3 Value Levers

If these have become trends in your supply chain, then it is worth considering which levers could be applied to drive improvement. The following diagram help categorise the order management issue into specific activities which companies can employ in their supply chain to release value back to their bottom line.

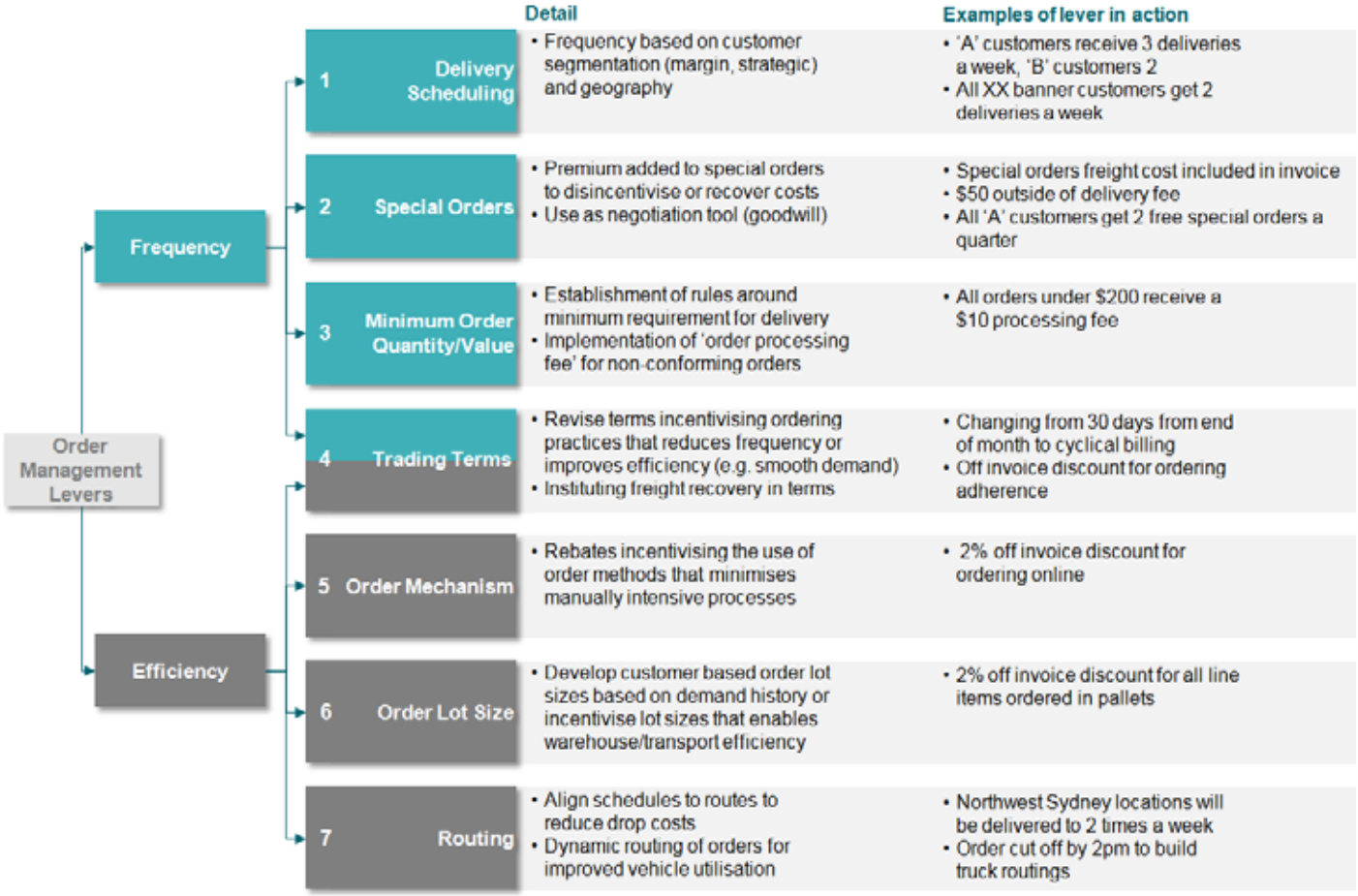

Figure1: Value can be released through a combination of supply chain and sales levers

In order to effectively implement an optimised order management solution, a detailed understanding of your products, suppliers and customers should be evaluated before assessing the current enablers and quantifying the value of each potential work stream.

Best practice companies exhibit the following characteristics aligned to the above value tree:

1. Delivery scheduling considers average value per drop and strategic importance of customers in determining the frequency of delivery. Internal performance reviews flag those customers that are underserved versus those who have excessive deliveries, and adjustments are made on a timely basis.

2. Special orders are either recouped or limited to strategically important customers and the cost of these is flagged within the business. For some customers it can be used as a gesture of goodwill and leveraged as part of the broader commercial negotiation. Sales account managers conduct regular reviews with their supply chain colleagues to understand the economics, frequency and underlying drivers of special orders at a customer level.

3. Establishment of order MOQ/MOV is based on a data based understanding of cost to serve and capability. MOQs are strictly enforced with accountability for any discrepancies owned by Sales.

4. The Sales team are aware of the impact of the trading terms they establish with customers. Customers are incentivised to order in a smooth pattern as required during a month instead of trying to capitalise on trading terms. Limited product promotions within supply lead times are accepted.

5. Customers are incentivised to use order methods that limit human input requirements (e.g. online). Processes and systems are constructed to facilitate.

6. Warehouse constraints are considered in determining customer order options. Order policies and timetables assist warehouse and delivery operations while maintaining high customer service levels. Order lot sizes are in some cases customer specific and aligned to optimal distribution packaging.

7. Runs are optimised, often using routing software, to balance deliveries (# drops and value) and standardise length per run. Simple tools exist to support mode selection (e.g. cross dock versus direct delivery). The leadership team regularly reviews opportunities to consolidate/outsource distribution where commercially feasible.

1.4 A Typical Result

The following case study outlines the typical benefits that we have seen from an order management optimisation program at one of our clients.

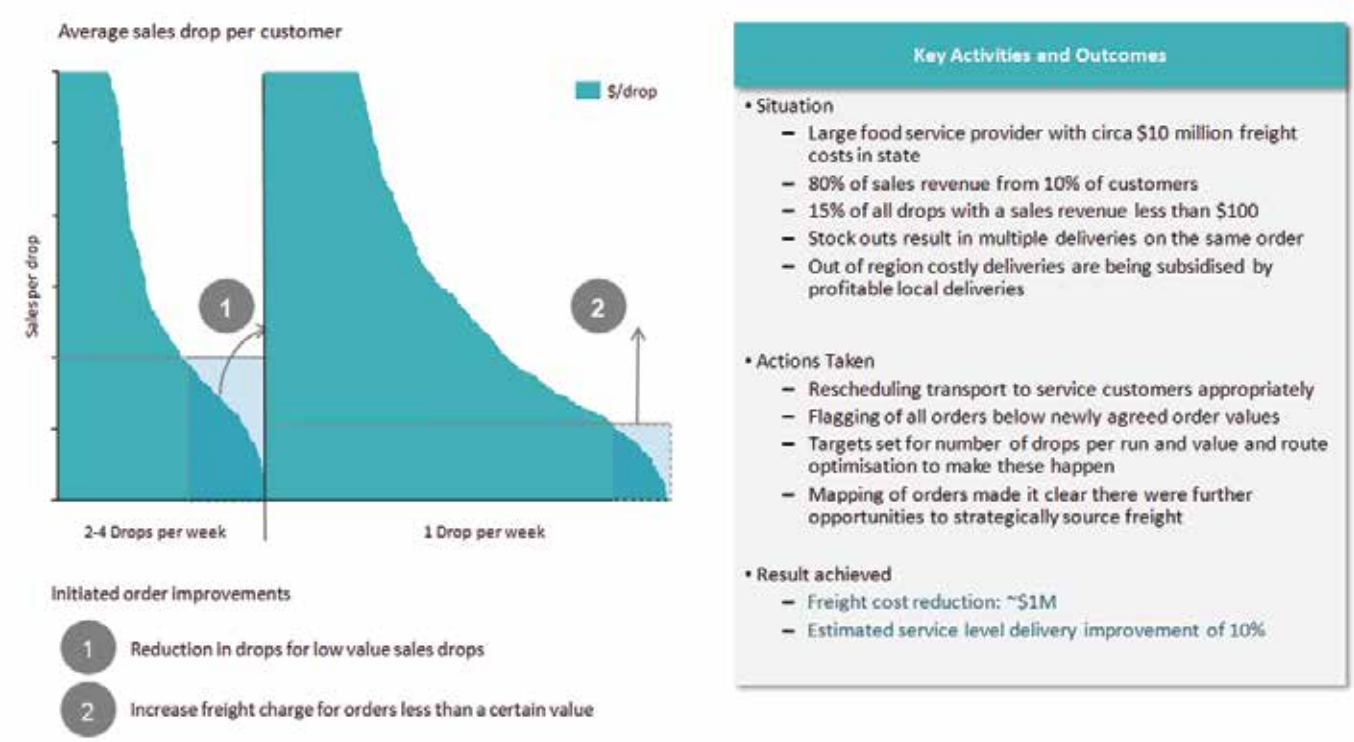

Figure2: A large NSW food service provider was able to save 10% of their freight costs through better order management processes and improved freight procurement

1.5 Conclusion

As the global market becomes more competitive the need for Australasian companies to improve their cost base and increase service levels will only intensify. Order management optimisation is often overlooked in the search for supply chain cost savings. However, the achievable benefits versus the ease of implementation of some of the levers mentioned in the above article suggest that companies that do so may be losing out on releasing significant value.

About the Author

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