WHITE PAPER

THE IMPORTANCE OF A SUPPLY CHAIN PERSPECTIVE IN PROCUREMENT DECISIONS

Abstract

The concept of procurement, the acquisition of goods or services, has been around for thousands of years. While the objectives have not changed dramatically, the ability to acquire a product or service at lowest possible costs while meeting the buyer's needs in terms of quality, quantity and time, has become increasingly complex.

Similarly, the fundamentals of the supply chain have been deployed since prehistoric hunter/gatherer times although the objectives have moved well beyond survival and are now congruent in many ways with those of procurement namely to meet customers' needs in terms of quality, quantity and time whilst minimizing, transport, storage, and working capital costs.

Infosys™ Portland

Key challenges in today’s environment

Both the supply chain and procurement disciplines are key to business success and their similarity in scope is evidenced within organisational structures globally - procurement may report into supply chain, supply chain into procurement or remain as independent departments with a seat at the executive table or reporting to the COO or CFO.

Table 1 lists criteria that keep CEO’s awake at night as they navigate how to deliver value to their shareholders. Well planned and executed supply chain and procurement functions contribute significantly to the overall performance of a business.

Key Criteria

Revenue Growth

Supply Chain Influence

Improved Customer Service

- Product availability
- Reduced lead times
- Responsiveness

Procurement Influence

Improved Customer Service

- Component quality
- Supplier reliability

Key Criteria

Net Operating Margin & EPS

Supply Chain Influence

Lower Supply Chain Costs

- Manufacturing
- Transport
- Warehousing
- Administration

Procurement Influence

Lower costs through procurement

- Raw materials
- Goods for resale
- Services (Including 3PL service providers)

Key Criteria

Cash Flow & Return on Capital Employed

Supply Chain Influence

- Optimised network
- Demand forecasting and replenishment
- Inventory optimization

Procurement Influence

- Capital procurement

Key Criteria

New Product Development

Supply Chain Influence

- Speed to market
- Responsiveness
- Robust planning
- Packaging design

Procurement Influence

- Raw materials/ component procurement

Key Criteria

Reputational Risk

Supply Chain Influence

- Chain of responsibility
- OH&S
- Minimising greenhouse emissions

Procurement Influence

- Sustainable procurement
- Quality

Increasing customer and society expectations are also placing more contemporary demands on the supply chain. These include:

- Sustainability: Transport is the fastest growing source of greenhouse emissions and is estimated to be responsible for >20% of carbon dioxide emissions in the future. With the introduction of the carbon tax the costs to supply could change dramatically.
- Globalisation: Products are being sourced globally to take advantage of such elements as labour rates and specialised manufacturing, impacting lead times and inventory requirements. (see figure 1)
- Modern Slavery: Organisations need to ensure their extended supply chains are compliant with legislation

How many countries does it take to make a coat?

To make this jacket for the UK market, a Hong Kong garment producer ordered materials from factories in five countries and had them delivered to Thailand, where the jacket was stitched together. Using a network of websites, the producer stays in touch with its worldwide suppliers and can compress the time it takes to get items into stores.

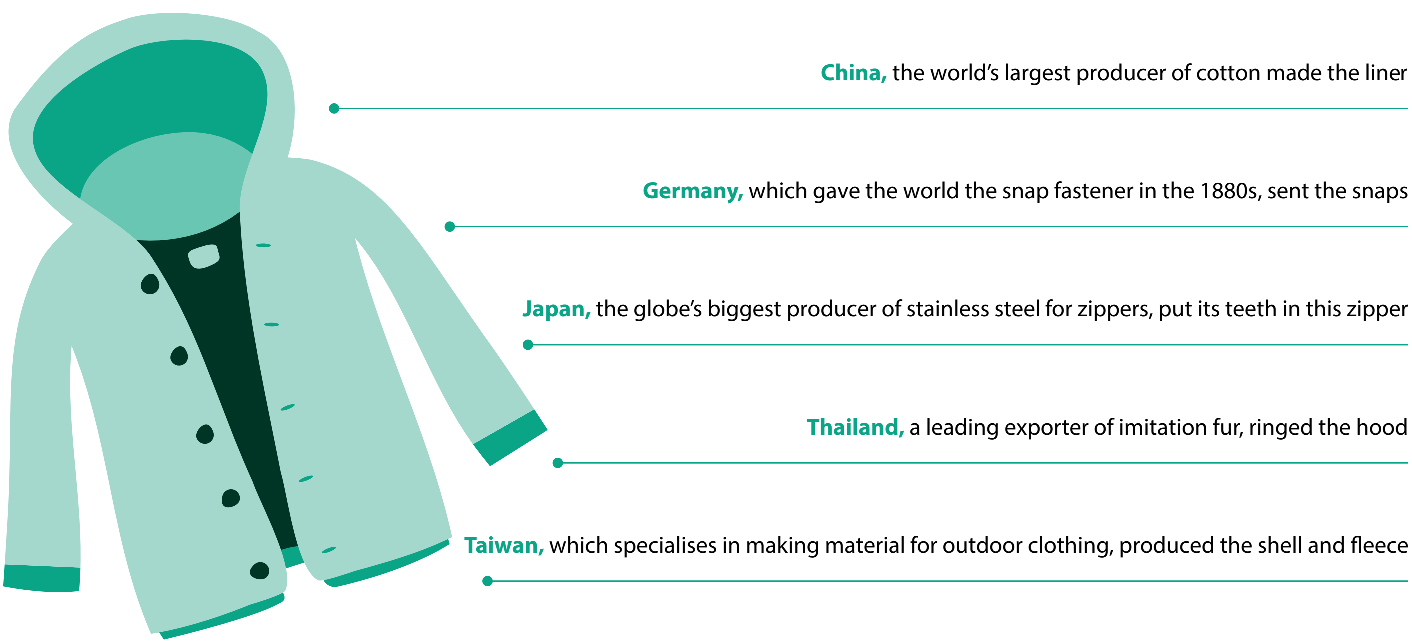

Figure 1: Globalisation of Supply Chain Source: Martin Christopher (2007)

Global supply chain practices and cost reduction opportunities are dynamic. Business cases that closed Australian factories to source ex Southern China was a viable recommendation 10 years ago. However as China's cost of labour increased, Australia's technology capabilities improved and become more efficient, customers demand shorter lead times and lifecycles along with large increases in sea freight now make these cases far less compelling.

- Increased Risk: Business decisions to dramatically reduce working capital, consolidate the supply base and outsource operations reduce 'buffers' to react to unplanned changes. This has been dramatically exposed by the COVID-19 crisis

In a study of 800 companies that announced a supply chain disruption between 1989 and 2000 Singhal and Hendricks identified that over a 3 year period the affected companies delivered 33% - 40% lower stock returns relative to their industry peers and typically required in excess of two years to fully recover.

- Product Proliferation and Reduction in Lifecycles: The variety of products offered often increases the number of inputs and suppliers (see figure 2), while the typical life cycle of a product has decreased causing increased product (and material) write-offs/downs.

In addition to brand/SKU proliferation retailers globally are pushing to increase the penetration of their own private labels which are often supplied by the brand manufacturers at greatly reduced margins requiring lower cost supply chains and lower cost of input materials.

Figure 2 provides an example of product complexity and proliferation impact areas of the organisation that include: customer order processing, manufacturing planning and scheduling, purchasing, inventory management, and quality.

Brand

Variants and Packaging

The brand Coca-Cola has many variants such as Vanilla Coke, Diet Coke, Coca-Cola Classic and Coke Zero

Each of these variants have their own unique packaging, which may require different suppliers.

Figure 2: Product Proliferation

- Business alignment: Customer requirements (e.g. multi/omni- channel, many variants) often conflict with internal objectives (e.g. lean) and supplier capabilities requiring procurement to play a balancing act with stakeholders.

Addressing risks and Complexities

For these risks to be properly managed procurement must understand their supply chains for the various products and services it is acquiring. This includes:

1. Understanding demand and supply characteristics of the product such as demand variability and supply reliability
2. Mapping out all of the steps to get the product from the supplier to customer, identifying areas of potential waste and risk
3. Determining strategies that could be utilised to mitigate risk or reduce waste for discussion with key stakeholders
4. Utilising (or developing) metrics to measure and communicate areas of performance (and risk) to the broader business
5. Understanding the true "cost to serve" of a product through its lifecycle

Once this knowledge has been acquired, procurement and supply chain can collaboratively determine the total cost of ownership and managing the inherent risks that various options provide.

Total Cost to Serve

Contractually agreed direct costs of a logistics contract are the visible part of the total cost and reflect the underlying cost drivers. Procurement must understand these costs to effectively source products and services:

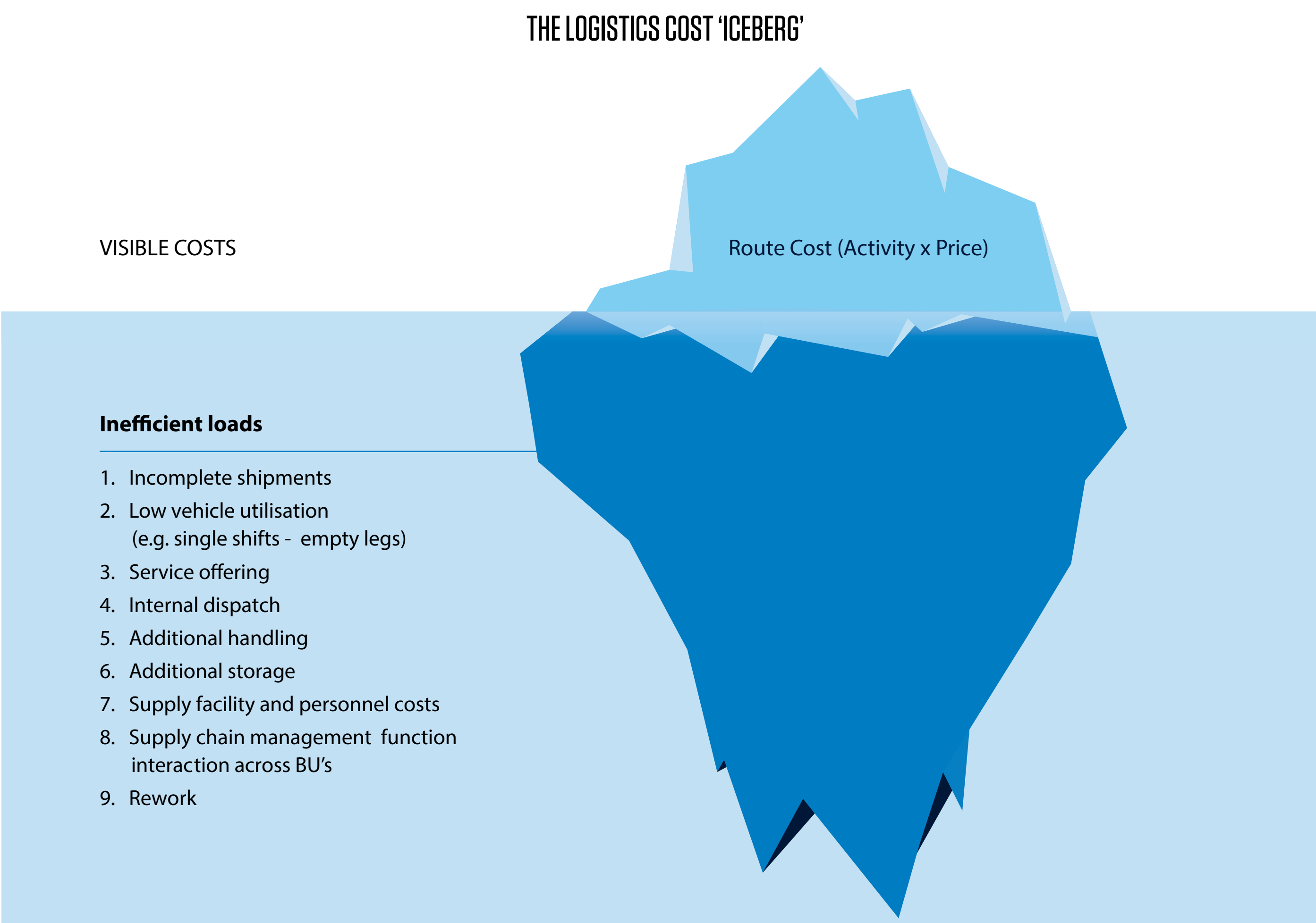

Fig 3: Cost to serve iceberg

Keys to Success

Procurement can take initiative in a number of areas:

- Taking ownership of the total 'Cost to serve'
- Taking a lead role on sustainability for products and services procured and understand the implications of various supply scenarios
- Training the procurement team (and the rest of the business) in total cost of ownership
- Assisting in off-shoring/outsourcing activities to ensure a comprehensive view is established
- Conducting workshops to identify vulnerabilities/ volatility in inbound supply chain & action them (this could include the supplier)
- Developing contingency plans and strategies based on potential outcomes
- Engaging key stakeholders across business in pursuit of goals. Timely, cross-functional meetings need to become part of the culture

Conclusion

The challenges identified in this paper will only intensify in the future and it is important that your organisation's Procurement function understands the diverse product and service supply chains that exist and work closely with key stakeholders to address and manage the various risks involved. Those that do it well are less likely to be impacted by the various challenges of today's operating environment and quicker to react when unforeseen events occur.

About the author and practitioner

Simon Coates

Simon Coates is a Director in Portland's Supply Chain Consulting Practice. he has over 25 years experience helping organisations improve their supply chain performance.

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Iestyn Williams is an Associate Director and has been delivering supply chain improvements in both Europe and APAC for the last sixteen years. Iestyn has a broad supply chain skillset having led programmes spanning supply chain strategy, supply chain planning, inventory optimisation, network design, transport operations, master data management and cost to serve.