Securing Competitive Advantage through Distribution & Logistics

Speak to the average Distribution and Logistics Head about improvement initiatives and the discussion invariably revolves around costs. A majority of the companies view this function as a cost head and focus effort on reducing logistics costs, rather than viewing it as a possible revenue enhancer. Few companies use Distribution and Logistics (D&L) as a means to enhance competitive advantage – barring those industries where logistics costs form a significant proportion of the controllable costs, e.g. cement industry. This article seeks to present a balanced view on the subject and identifies measures to utilise Distribution and Logistics as a source of competitive advantage both with respect to the topline and bottom line.

In the last few years, this function is receiving due recognition from industry with dedicated persons made in-charge of the function. A few years back, there were hardly any companies in India that had designations such as Head-Logistics and Supply Chain Head. However, the transition from viewing it as a cost head to a revenue enhancing opportunity is yet to happen. Most companies have yet to realise the potential of using Distribution & Logistics parameters, such as better servicing, to retain / acquire customers. With increasing competition and commoditisation, the level of service can be used as potential differentiator.

Shifting the Service – Cost Equilibrium

The level of service is bound to have a trade-off with the cost of servicing, as is illustrated in Figure 1. Most companies adopt initiatives that make them move up or down the curve depending on whether the emphasis is on better servicing or lower costs. This does not enhance a company's position, as one aspect is being improved at the cost of another. Enhancing competitive advantage is about shifting the supply chain exchange curve (from T1 to T2) so that you achieve better servicing at the same cost or lower costs at the same servicing level.

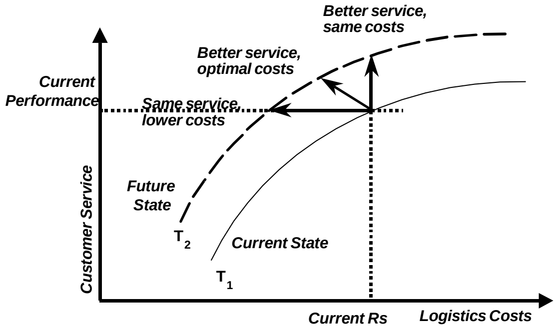

Figure 1: The Service – Cost Equilibrium

Initiatives to improve distribution and logistics performance tend to be operational in nature and these are well known – optimising redistribution centres, inventory management systems, warehouse management systems, etc. However, the strategic initiatives often get overlooked in the traditional micro-level approach to this issue. The Supply Chain Head would benefit significantly by covering the strategic issues first and then moving to operational changes.

Strategic Level Initiatives

The primary objective of the strategic level initiatives is to enable fixing realistic targets for servicing levels - preferably based on the product and customer profile - so as to ensure effective utilization of resources.

Differential Supply Chain Strategies

At a broad level, Differential Supply Chain strategies can be identified based on the type of product / service as well as the customer segments needs. A company's product portfolio could be classified into four categories – each requiring different supply chain strategies as a combination of service and costs focus. (Figure 2) For example 'mature products' would require a greater cost focus and relatively lower service focus. On the other hand for a new product, high service levels would be essential, even at a higher cost. Few companies adopt different service levels for different products. A broad-brush approach to target service levels then results in averaging out the performance level that is sub optimal for all product categories.

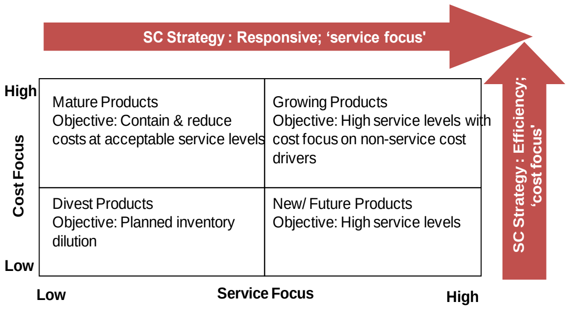

Figure 2: Differential Supply Chain Strategies

While this analysis is relevant for multi product companies, literally all companies can benefit from tailoring supply chain strategies to meet customers' needs and not over delivering.

Customer specific service levels

It is known that customer satisfaction (which is the ultimate aim of all such initiatives) does not have a linear relationship with service levels (degree of fulfillment). (*For more information on this subject refer to article 'Tailoring Relationship Initiatives to Customer Needs' by the same Author)*. Even within the two extremes of the satisfaction levels, there are points where customer satisfaction does not increase with increase in service levels. This is not surprising as every service level improvement need not translate into a value benefit to the customer. (Figure 3) Let us take the example of an engineering goods manufacturer supplying to a projects company. If the planning cycle of the customer is 20 days anyway then reducing the lead time to supply any faster is not going to result in any value addition / increased customer satisfaction. If you can bring it down to less than 7 days, then the customer may find it worthwhile to make internal changes and reduce his planning cycle and become more responsive. In such a case customer satisfaction would enhance further. This gap is the zone of customer indifference, and needs to be recognised to strategically design your improvement initiative.

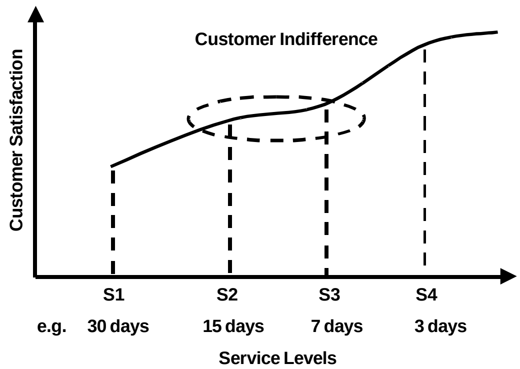

Figure 3: Targeting service levels to meet customer needs

Outsourcing

One strategic level decision that needs to be evaluated at the outset (before operational initiatives) is whether to outsource the distribution and logistics or to keep it in-house. Outsourcing logistics is increasingly becoming a strategic alternative to enhance performance. Third Party Logistics providers claim to be in a better position to offer better services and lower costs due to the opportunities in payload consolidation and aggregation, IT infrastructure spread over a larger volume of goods and better carrier negotiation. The decision would be a function of the servicing complexity versus the shipment volume which would vary by industry (Figure 4). Further, the need for direct control will be greater if the company is likely to be vulnerable to any fall out in the arrangement. Considering these conditions, there should have been a large number of companies outsourcing their logistic needs. This has not happened in India, essentially because the opportunity for consolidation and aggregation is limited, the fragmented structure of other sections of the logistics chain and the management's need for control is still quite high.

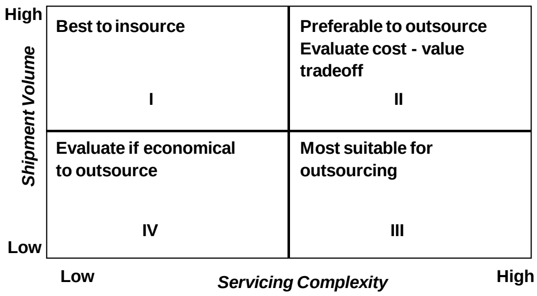

Figure 4: When to outsource?

Operational Initiatives

Operational initiatives are typically efficiency measures with a greater emphasis on cost reduction. The primary objective here is to reduce the cash-to-cash cycle i.e the time taken from paying the raw material suppliers, all the way to receiving payment from the customer for the converted goods. The component in this cycle which tends to be taken for granted is inventory. Debtor and creditor days are monitored with much vigour, but days of inventory (anywhere in the pipeline) get a lower priority. This is also a reflection of the resistance from the operational staff to cut down inventories.

Inventory Management

A client of Avalon Consulting manufacturing construction materials used to operate with an average of 13,000 T of finished goods inventory (1.2 months). No doubt it required to build-up inventory to take care of seasonal peaks in demand. And the inventory levels were justified by the fact that depot inventories touched almost zero during the peak season. However our analysis showed that delaying the buildup of inventory closer to the peak period (instead of throughout the non-peak period) brought down average inventory levels by almost 3000 T.

Structure Approach to Cost Reduction

The approach to cost reduction exercises can impact the ultimate benefit one can derive. A systematic and exhaustive analysis of the cost drivers can provide a wider set of avenues for cost reduction. For example under primary freight, companies essentially focus on the freight rate and negotiating the tightest contract with the supplier. One of our clients had squeezed the transport contractors using cost benchmarking and competitive bidding to such an extent that there was little scope for further reduction. However there were opportunities in changing the vehicle mix (larger payloads to reduce cost / ton) and transportation mix (sending some of the goods by rail) to reduce the overall freight cost by another 5%! Having looked at each cost head separately, the obvious next step was to optimise the redistribution centres and the supply sources to minimise the total costs (primary freight and secondary freight + intermediate storage costs). This analysis achieved a further 3% savings in the overall costs.

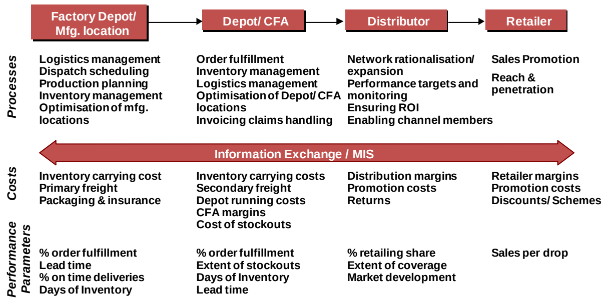

Figure 5: Opportunities for value enhancement across the distribution chain

There are several means to enhance competitive advantage through D&L. A structured approach to diagnosis and evolving solutions can reap rich benefits.

While it will take some years for the D&L industry to reach the evolved state of developed nations, Indian companies are definitely waking up to the importance of this critical part of the value chain.

About Avalon Consulting

Avalon Consulting is a premier management and strategy consulting firm. The firm was set up in 1989 and it specializes in providing solutions to business problems in the areas of Strategy Development and Implementation, Organisation Transformation and Innovation for clients in India and abroad. The firm has offices in Mumbai, Delhi and Chennai.

About the Author

Naimish Dave is a Partner at Avalon Consulting. He has almost two decades of experience in consulting and has advised clients in a wide spectrum of industries including food, agri-business, engineering and consumer goodsfor a diverse set of verticals. Naimish is also a member of the agri-business committee at CII. He holds a BE (Mechanical Engineering) from VJTI and an MBA from SP Jain Institute of Management and Research. He can be reached at Naimish.Dave@consultavalon.com.