

# Supply Chain EUROPE

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# TIME TO REVIEW YOUR CHINA SYNDROME

Bradley A. Feuling explains how Chinese and world developments are changing sourcing strategies.

**R**ecent trends are creating challenges for companies focusing solely on sourcing from China.

Where profits were once significant, many companies are now concerned with breaking even — driven by increasing costs. In early 2008, 70.6% of exporters raised their prices and China's Production Price Index (PPI) increased by 7.6%. In addition, a 2008 HSBC study noted an average annual salary increase in manufacturing by 105% from 2000–2006. At the same time, consumers and buyers are requiring lower price points. As Dow Chemical Vice President, Patrice Barthelmes, recently stated: "Competition, consolidation and smaller order sizes continue to squeeze margins, while pressure for faster delivery, tighter deadlines and smaller runs rise." These dynamic and highly influential factors are impacting long-term supply chain sustainability. To protect profits, increased co-ordination with suppliers and customers is required. This marks an important transition from product characteristic purchasing to upstream and downstream integration, bringing the supply chain together. Aspects such as supplier procedural operations, logistics consolidation and inventory placement can reduce risks such as upstream capacity bottlenecks while improving profitability.

## Bringing it Together

Often, a misunderstanding of what the supply chain actually is inhibits operational efficiency. For many in procurement or sourcing, the supply chain refers only to the material flows that the company directly manages. This includes order placement, inbound logistics, deconsolidation, warehousing or

distribution, and shipment to the customer. In fact, however, the supply chain includes the end-to-end material, information and financial flows governing a product. The key to improvement is a systems theory approach. How do we build a seamless network integrating material, information and financial flows? How does profit sharing co-ordination or cannibalism impact competitive sustainability? How do upstream capacity risks affect downstream fulfillment?

## Ensuring Supply Chain Capacity

One of the drivers for integration is the need for stable production capacity. Transitioning from one supplier to another is costly. These costs include quality variance and setup time. As upstream bottlenecks influence the entire supply chain's service level, minimizing risks at this critical point is of primary concern. The reality remains: when you buy a product, you buy the supply chain. As the financial downturn taught many, a critical component of upstream capacity is financial flows. When combining lower industry profit margins and lengthy, sometimes unremitted payment from foreign buyers,

Chinese manufacturing becomes extremely susceptible to failure. This was exemplified by the discontinuation of business operations for an estimated 800,000+ companies in 2008. Without stronger supplier integration, sudden capacity shocks can have detrimental affects. To advance supplier and supply chain operations, greater knowledge dissemination for such risk mitigation strategies is required.



### Improving Supplier Operations Knowledge

Supply chain knowledge is still new. Many trace the founding to the 1980s when increasing global competition required improved co-ordination between once independent contributors. It isn't surprising that many low cost country suppliers have little supply chain knowledge. Because of this reality, it is imperative to increase information flow to further reduce operational costs. Take for example, Fuji Xerox (China) Ltd, a leader in the printer and computer peripheral hardware industry. Previously, the company faced a number

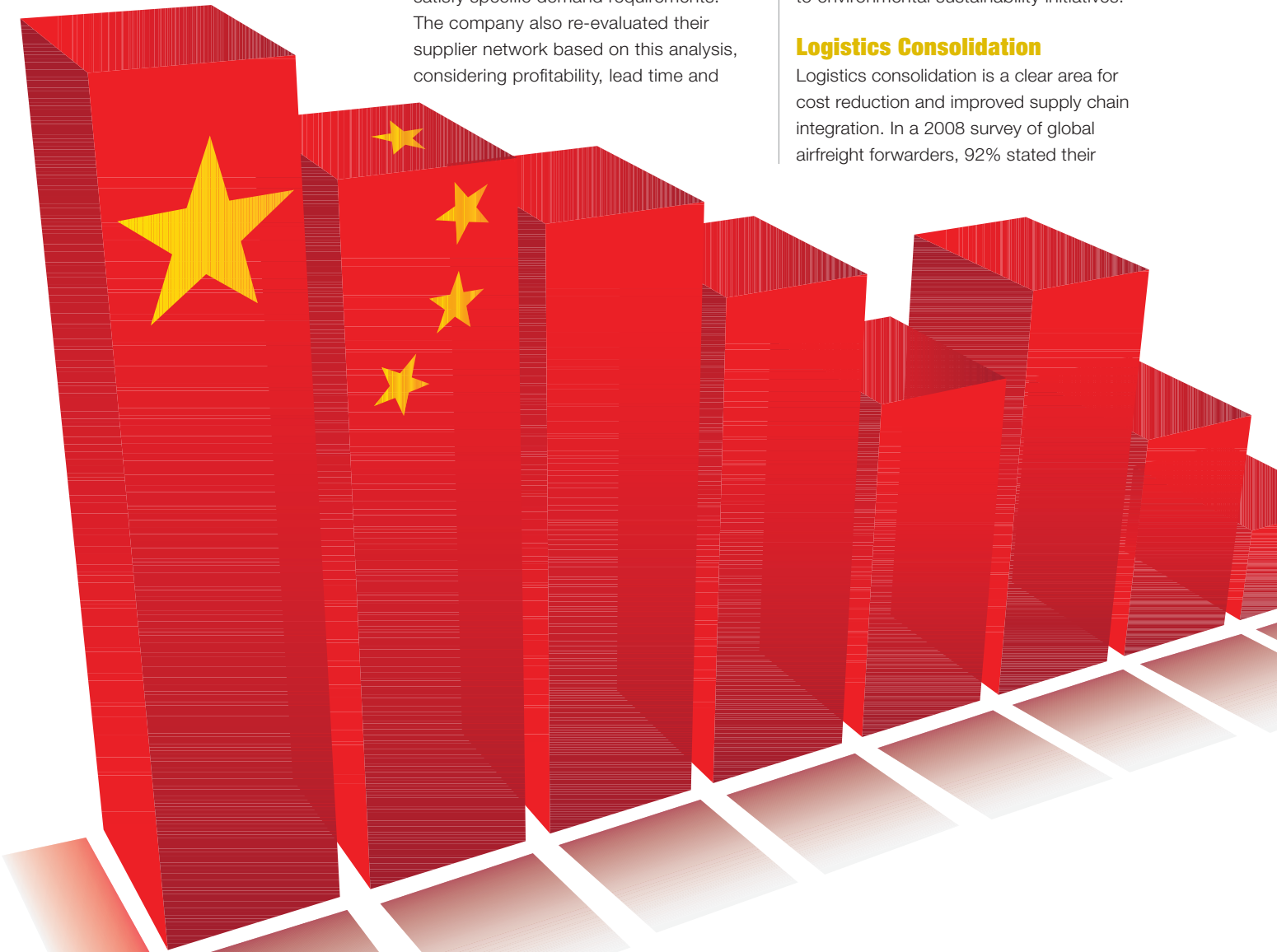
of challenges stemming from internal cross-functional information flow, including the company's complex supplier network. At the time, Fuji Xerox didn't have a clear process to integrate operations between material inputs in their production and end-customer demand.

To improve, Fuji Xerox established a cross-functional group, including employees from different divisions such as inventory, manufacturing and supplier management, in addition to quality control, finance and IT. As each product segment had different distribution channels, every process was analysed and designed to satisfy specific demand requirements. The company also re-evaluated their supplier network based on this analysis, considering profitability, lead time and

procurement costs. For some products, the organization moved to make-to-order, for other products, Fuji Xerox focused on production planning and supplier operations to shorten lead times to delivery. By exchanging knowledge of capacity, throughput, and inventory order processes with suppliers, Fuji Xerox was better able to align their operational processes. The company increased customer satisfaction to more than 95%, while reducing total inventory by nearly 50%, as well as the cost of goods sold. Stronger demand forecast accuracy and planning also resulted in a decrease of quality defects and contributed to environmental sustainability initiatives.

### Logistics Consolidation

Logistics consolidation is a clear area for cost reduction and improved supply chain integration. In a 2008 survey of global airfreight forwarders, 92% stated their



customer base had expanded by 5% or more and 24% indicated a 15% growth in new clients, according to Inbound Logistics magazine. For transoceanic freight, the expansion of service for less-than-container loads (LCL) showed similar industry trends. For many procurement offices, there is little knowledge of logistics capacity utilization. In most cases, suppliers are directly involved

cross-docking facilities. This is vital, not just for major players, but also SMEs.” These opportunities extend to sourcing operations. Significant savings are created when consolidating freight to reduce fuel costs and LCL shipments. Similarly, packaging optimization can be achieved when combining product shipments to a shared location. What is commonly a

costs will affect profitability. This can result in in-transit expedited freight for example, created by a need to place inventory closer to the customer.

The Bullwhip Effect is also playing a large role in Chinese manufacturing. Inventory management challenges are often systemic. For example, inefficient replenishment policies for a supplier not only potentially lead to an increase in costs for transportation, stock-out and inventory holding, but also the risk of material substitutions. All too often, supplier management in China is done with a hands-off approach, where limited technical and supply chain knowledge is transferred. To improve operational efficiency, lower capacity bottleneck risks and reduce costs, supplier integration is vital. With the growth of global supply chains, avoidable risks may be magnified.

For all companies, the cost of inefficient supplier management is tangible. Product recalls, for example, are often a result of material input substitution caused by a stock-out of inventory. Production delays can occur for the same reason. Although we may assume that the decisions were made as a result of malice or ignorant decision making, the reality in most cases is that integration and transparency with China suppliers still remains low. This fragmentation in the supply chain can pose significant threats to all subsequent contributors. China’s position as the manufacturing centre of the world and leading export economy suggests it will be some time before other low cost sourcing destinations grow to such proportion. With Chinese manufacturing’s youthful role in global supply chain operations, further advancements in efficiency, environmental sustainability and cost reductions will be a focal point for upstream operations in the years to come. ●

## Logistics consolidation is a clear area for cost reduction and improved supply chain integration

with container loading. This makes it difficult to assess cost savings from consolidation, where many companies prefer to collaborate with 3PL partners. Still, the root cause has not been addressed. Small batch production remains unco-ordinated among suppliers, hence cube utilization is lower and unnecessary costs remain.

LCL shipping is just one example, which is often a result of poor demand-production synchronization. In addition, few supplier managers consider production batch optimization, concerning themselves rather with product volume ordering. A key consideration here is lead time, as well as working capital and currency exchange risk. To minimize operational cost factors, cycle time planning, inventory management and co-ordination must be included as well. Interestingly, these are focal points in improving profitability. Some companies are focusing on logistics consolidation by partnering with an unlikely bedfellow, their competitors. As Dean Wyatt, Business Director and Head of Development, Food Retail DHL Exel Supply Chain, notes: “With increased requirements to cut unnecessary logistics, development is needed in shared transport or warehousing, consolidation centres and multiuser

consideration of material costs is now becoming a concern to reduce logistic costs. By involving upstream contributors in packaging, consolidation and deconsolidation processes, inefficiencies that were once unrecognized can now be improved upon.

### Inventory Placement

Many foreign buyers question minimum order quantities (MOQ). This disconnect in planning is derived from the now permeating strategy of companies such as Zara. By shortening lead times and building business models around material and information flows, inventory can be secured to meet shorter demand cycles. Most operations, however, are built on legacy models where high-volume production means lower costs. Larger production and inventory carrying is based on lengthened forecasting models. For example, a distributor with long lead times will almost always build higher levels of inventory than are necessary. Manufacturers do the same. With shipping lead times of 4–8 weeks, depending on the destination, upstream costs are higher as working capital is tied to inventory. If inventory placement is not adjusted as variables change, unnecessary

### For more information

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