Cost still key in supply chain strategies

AMSTELVEEN, NETHERLANDS: New perspectives on risk are changing supply chain strategies yet cost remains key, finds new KPMG International Survey, and what has become evident is that putting excessive emphasis on cost is not always good for the relationships you have with your suppliers.

- Industry leaders developing new supply chain models strategies
  to manage risk, gain advantage
- Many concede excessive focus on cost has damaged relationships with suppliers
- A shrinking supply base and more long-term contracts help enhance value of supplier relationships.

A clear majority of leading industrial companies still see cost as their main priority when managing supply chains, despite emerging evidence that excessive focus on cost has damaged relationships, and that new approaches to supply chain management are gaining hold among leaders in the field, a survey from KPMG International has found.

The survey, entitled *Global Manufacturing Outlook - Relationships, Risk and Reach*, polled nearly 200 senior-level executives from the aerospace, metals, engineering and conglomerates sectors across North America, Western Europe and Asia-Pacific to understand how their supply chains were changing as a result of prevailing economic uncertainty.

It revealed that cost still reigns among 66% of respondents as the leading consideration of their supply chain models. But 63% of respondents agreed that more attention should be paid to non-financial elements of the supply chain and 38% said that an acute focus on cost has harmed relationships with suppliers.

The survey also showed that many of the world's leading companies are applying new methods of supply chain management designed to weather an economic climate where various forms of risk have become the norm. These new approaches - more strategic than tactical - could well emerge as best practices.

Too much focus on cost... can cost you

"The fact that nearly 40% of respondents acknowledge that a focus on cost has done damage to relationships with suppliers is an alarming statistic," said Jeff Dobbs, global head of diversified industrials for KPMG. "Those businesses that continue to follow the traditional 'low cost or bust' models in supply chain management are at risk of losing a foothold in the market."

In interviews with bellwether companies such as Philips, Leggett and Platt, Rolls-Royce, US Steel and Tata Chemicals it becomes clear that new supply chain strategies are emerging. The survey revealed that some companies are forging stronger relationships and engaging in collaborative innovation with suppliers; strategically investing in key suppliers or bringing parts of the supply chain back in-house; and applying a mix of both regional and global supply sources to achieve the best combination of speed, quality and cost.

"It used to be that sourcing decisions rested on routine considerations," Dobbs said, "like who could make the best component for the best price. This approach worked when there was little variability in input costs. Now, leading supply chain strategies must involve detailed scenario modelling to determine the appropriate response to a host of volatile elements. The most successful companies will be those who build adaptability and flexibility into their supply chains."

Deeper relationships

Having stronger and deeper relationships is critical among leading companies with 53% of respondents expecting to enter into more long-term contracts but with fewer suppliers. Cost remains the key driver for much of the collaboration.

More important than the duration is the depth of the partnerships. Over half of the respondents plan to collaborate more closely with suppliers on product innovation and development, research and development (R&D), and cost reduction. Such collaboration appears to be a preferred approach among the top performers.

"Viewing the supplier relationship as a strategic partnership helps top performers ensure certainty of supply, improve demand planning and fine-tune the mechanism for getting product to the customer," said Tim Waters, director for KPMG's Performance and Technology Advisory practice in the UK.

New perspectives on risk management

Top performers are also paving the way in cultivating relationships and controlling risk when it comes to R&D and sharing intellectual property (IP).

While 26% of survey respondents see IP protection as one of their biggest supply chain risk concerns over the next two years, cooperative innovation on IP can be very lucrative with the proper risk management in place.

China presents a particular IP challenge and respondents continue to look to that country largely for low-end jobs, such as production of goods involving little IP, assembly, and warehousing. Companies like Philips, on the other hand, which has several joint innovation projects and patents there, are benefiting from China's increasingly strong and innovative technological base.

"A progressive way of thinking contends that companies should be willing to look outside their businesses for potential IP and be willing to license out any IP not core to their business," Dobbs said.

Sourcing geography

China remains the most common sourcing location among 35% of respondents. When asked where respondents expect to increase sourcing over the next two years, China also ranked first (39%), with India not far behind, at 26%. Cost remains the predominant deciding factor.

Yet some top performers are thinking beyond sourcing locations for low-cost alone and considering ways to align supply chains and their inherent geography to other key considerations such as the business model, market dynamics, local talent pools, customer profiles and demand.

"The financial crisis dealt a blow that sent shockwaves through the industry, but those same forces are the catalysts that are helping organisations create more dynamic, resilient and responsive supply chains," Dobbs said. "It's incumbent upon businesses to embrace new ways to use the supply chain to future-proof their business models."

Note:

KPMG International commissioned the Economist Intelligence Unit to survey a total of 196 senior manufacturing executives, all of whom are involved in some way in supply chain strategy. Of these 40% were C-suite or above. 36% were based in Western Europe, 32% in North America, and 23% in the Asia-Pacific region, with the remainder coming from across the rest of the world. All participants represent companies with more than US$1 billion (about R7 billion) in annual revenue; 42% work for firms with more than US$5 billion (about R35 billion).