

SUPPLY CHAIN MANAGEMENT: A BOARDROOM IMPERATIVE

AN FTI CONSULTING BRIEFING PAPER



AMAZON

In December 2014, hundreds of Amazon workers in Germany went on strike, just as pre-Christmas sales were set to peak, in a dispute over pay and conditions. "Our customers can continue to rely on us for the prompt delivery of their Christmas presents" a spokeswoman said, adding that Amazon would use its whole European logistics network over the Christmas period to ensure delivery times were met. Amazon then went on to announce it would build three new

logistics centres in Poland and two in the Czech Republic, prompting speculation that it could seek to shift work across the border from its strike prone centres in Germany.

APPLE

Apple's innovative technology, design and world-class marketing have created a large, loyal customer base that has made their products some of the most iconic in history. Apple's recent release of the iPhone 6 sold more than four million

phones in pre-order within the first 24 hours alone.

Yet there is another unseen aspect to Apple's success – outstanding supply chain management. Apple's supply chain has been ranked #1 by Gartner, five years in a row. Gartner quotes that "Apple's supply chain success is mainly based on their strong IT system, a streamlined product portfolio, their supply chain monitoring technology and collaborative demand planning with suppliers".

Both Amazon and Apple have made significant investments in their supply chain capabilities to create a powerful source of competitive advantage. It's clear that for companies to effectively operate in a competitive environment, optimising their supply chains needs to be an ongoing board level imperative.

The very best companies continue to evolve and innovate in how they manage their supply chains, but supply chain management can be complicated. The interaction between the numerous business functions from sourcing,

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production and distribution to sales, combined with working capital and funding constraints mean that managing and optimising supply chains requires an interrelated set of solutions.

Globalisation, changing customer requirements, increasingly complex distribution networks or managing

a return to growth following an economic downturn, all of these make managing supply chains more difficult. Furthermore, structural changes to a company's supply chain - requirements to supply new markets or achieve synergies in post-merger situations - can add a further layer of supply chain complexity.

THREE BENEFITS OF SUPPLY CHAIN OPTIMISATION

Based on FTI's experience in supporting clients develop and improve their supply chain we see three key benefits from supply chain optimisation:

1 Effective supply chain management is a key enabler for growth. This could be through managing revenue growth following a downturn or more structural changes such as entering new markets. The latter involves a number of stages each with a significant supply chain impact. For example, a company may start by delivering internationally to new markets with high logistics, customs and duty costs. The next natural evolution may be to support rising demand through the creation of a local joint venture with your local partner managing the supply chain. Finally, as demand continues to grow and local joint venture production is established, management could decide to create a wholly owned subsidiary and manage a new, more complex international supply chain with multi-sourced supplies and international

distribution. This evolution, and its individual steps require a structural change and effective management to support an increasingly complex supply chain.

2 As evidenced with the case studies of Amazon and Apple, when optimised, an effective supply chain can offer businesses a substantial competitive advantage. Likewise, the effects of poor supply chain management can adversely impact a business resulting in losing sales, falling profits, increasing working capital which finally results in competitive dis-advantage.

3 Supply chain management has a significant impact on profitability. Total supply chain activities including procurement, warehousing, distribution and production account for a significant portion of total operating costs. Consequently, supply chain management is of obvious importance to corporates and financial sponsors alike, with the latter investors having very stringent return requirements.

In order to maximise return from any transaction, investors have to focus on leverage and revenue growth, and the business has to change operationally or restructure its basic processes in order to realise maximum value. This is where supply chain optimisation can play a very important role.

Clearly there is a compelling argument for optimising the supply chain but how can companies best address these challenges?

THREE BENEFITS OF SUPPLY CHAIN OPTIMISATION:

1. Effective supply chain management is a key enabler for growth
2. An effective supply chain can offer substantial business advantage
3. Supply chain management has a significant impact on profitability

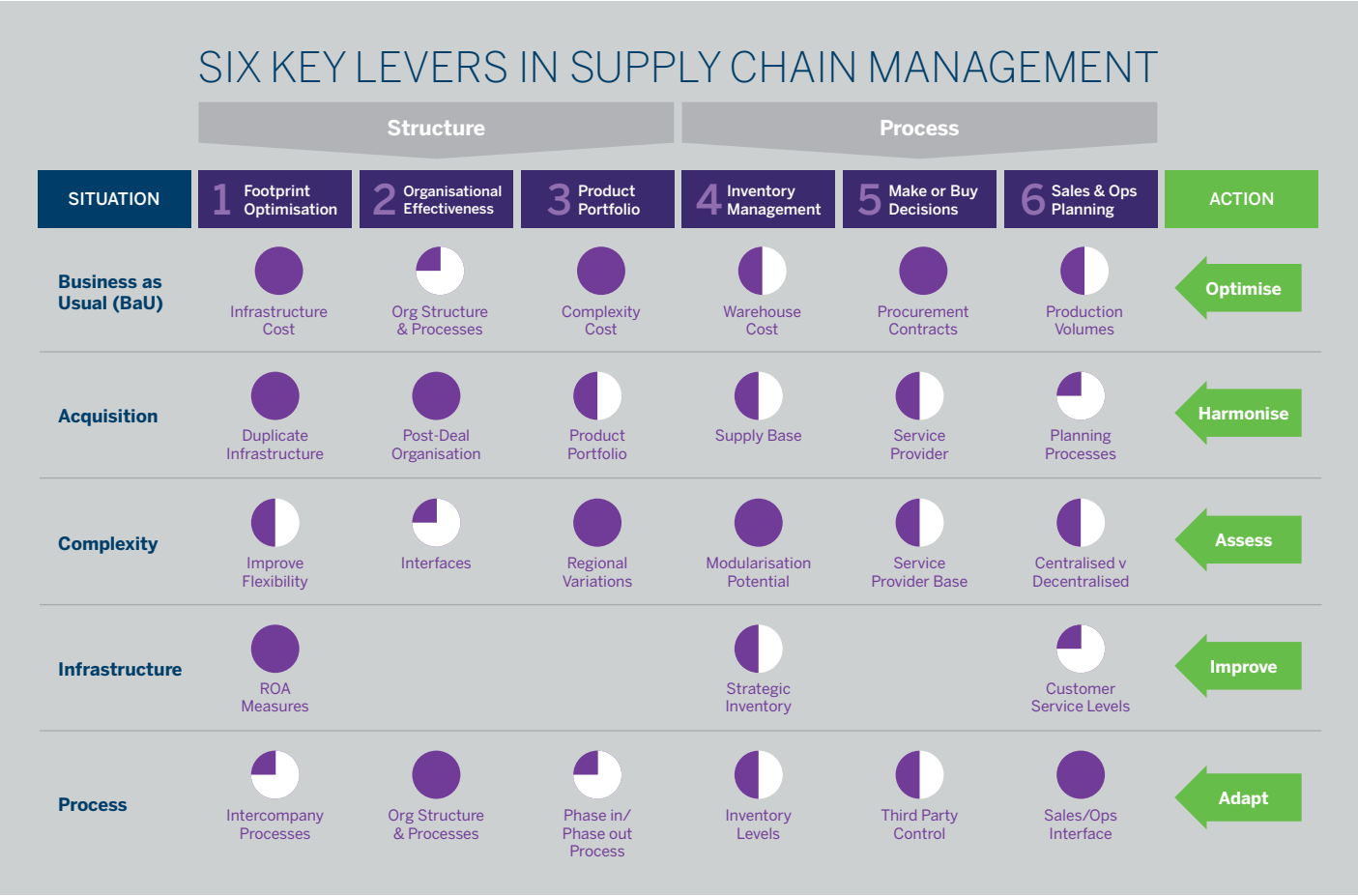
PUTTING THE WHEELS IN MOTION

Through extensive global experience of delivering supply chain improvement projects, FTI Consulting has developed a proven approach. According to Andreas Von Keitz, Senior Managing Director in FTI's Operational Transformation practice, the starting point for targeting areas for improvement should be based upon a detailed screening of current supply chain performance to identify areas for change.

The key areas for improvement range from **structural aspects** such as a company's overall physical footprint, to **key processes** such as inventory management or sales and operations planning.

While no two situations are the same, there are a number of key levers to target for improving the supply chain that, in our experience, remain consistent.

The diagram below describes the six levers for supply chain improvement and the contextual observations that indicate when something may not be optimised in the existing solution.



The supply chain can be impacted by a combination of the six key levers set out above. According to Bjoern Thomas, a Senior Director in FTI's Operational Transformation practice, growth, organic or acquisitive, impacts on both the BaU and Acquisition horizontals but also all of the levers. Therefore an action is required to optimise and harmonise the 'new' supply chain requirements to meet the changed business needs. This can be delivered, for example, through footprint optimisation or improving operational effectiveness. Mergers and acquisitions (M&A) activity can have a significant impact and can add a high degree of inefficiency across the supply chain if not managed properly. Based on our experience, in supply chain transformation programmes and M&As,

the supply chain complexity and the impact on company performance are very often neglected.

Reducing complexity is also achieved through a product portfolio that can address both input and output stock keeping units (SKUs). This enables a simplification of inventory management systems and can lead to product redesign and modularisation. Similarly the need for effective cost and cash management impacts on minimising inventory levels, reducing complexity across the supply chain and the companies subsequent 'make or buy' decisions.

We can see that a decision in one area can have profound implications elsewhere in the supply chain.

Time, business strategy and tactical priorities will dictate which of these six levers the business decides to focus on. Clearly management must be aware of the full implications across the entire supply chain.

A transaction, especially a merger, should be a trigger for a full review of the existing supply chain system. Complications often arise due to the structure of the business that was contemplated as part of the transaction not being fully implemented post-deal leading to a potential loss of value. For example duplicate infrastructure, a supply base that has not been rationalised or the replication of support functions are all value enhancing opportunities that remain on the table.

As a result cost savings are not fully realised and targets for synergy benefits at the start of the deal are not met.

In scenarios such as this we would prioritise targeting at least four of the six supply chain areas in order to realise significant EBIT(DA) and cash improvements;

1 Footprint Optimisation

A detailed assessment of the opportunities and benefits of the various strategic options which may include closure, downsizing and/or expansion in order to optimise a company's physical footprint whilst creating flexibility and responsiveness across the network.

2 Organisational Effectiveness

Based on a function by function analysis of overlapping responsibilities and consolidation opportunities with the overall aim of reducing resource requirements whilst delivering an efficient and effective network.

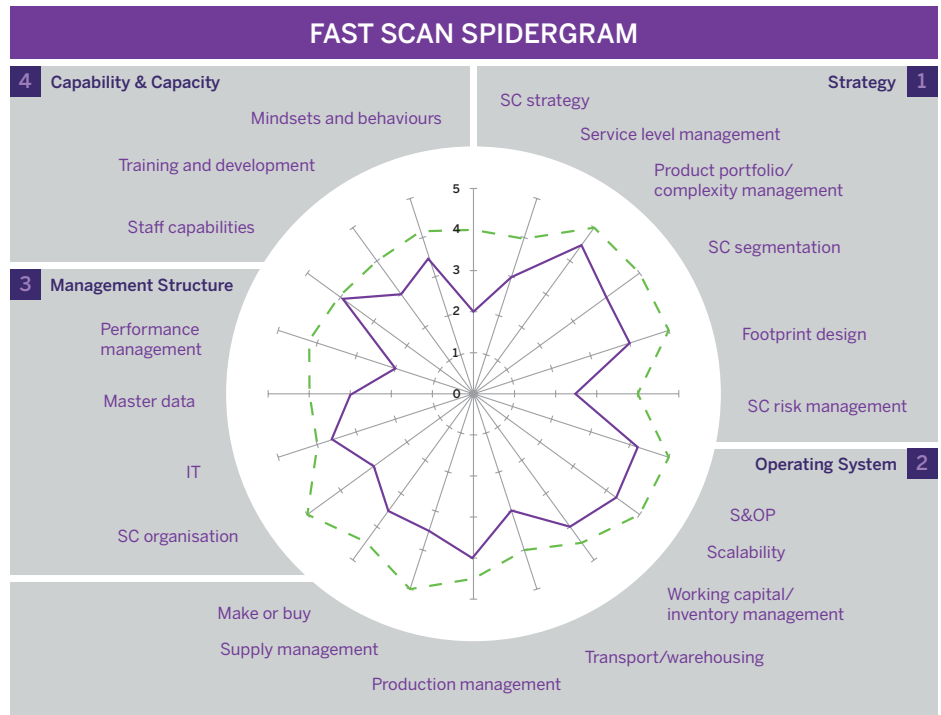
3 Product Portfolio Optimisation

'Quick wins' often exist in the identification of underperforming SKUs and identifying whether to stop, continue or change based on achieving satisfactory price increases. Importantly putting in place an ongoing portfolio review process as part of each budget process should be a key outcome. Many automotive original equipment manufacturers (OEMs) adopt this alongside a modular or platform-based approach to product design in order to reduce complexity and achieve better economies of scale. The complexity of such initiatives should not be underestimated as the impacts will affect all business functions and require strong commitment and leadership from senior management.

4 Inventory Management

Many businesses view themselves as making to order. However, in our experience many actually make to stock due to, for example, minimum order quantities. A starting point in looking at this is to understand how integrated the sales and operations planning process actually is. How often are the key parameters, such as definitions of 'excess stock' reviewed and changed? Multinational companies are often renowned for their inventory management systems such as 'just in time', often carrying only a few days, or even hours, of inventory.

FAST SCAN, ITS FOUR KEY DIMENSIONS, AND THE USE OF UP TO 40 DETAILED REVIEW DIMENSIONS ENABLES A STRUCTURED PROGRAMME TO BE DEVELOPED TO CREATE A BESPOKE AND FOCUSED DEVELOPMENT PLAN



The use of Kanban 'just in time' material control alongside other techniques can be adapted to work in most situations in order to reduce inventory and release cash.

As an evolution to the six levers, FTI Consulting developed a 'Fast Scan' approach (diagram above) which is a detailed development of these levers for use as a rapid business diagnostic. The methodology was developed to enable our supply chain and deal teams to focus on the most important issues and opportunities during just a few days scan to identify key priorities for improvement.

The Fast Scan Spidergram is structured along the four key dimensions of supply chain management: 1) Strategy, 2) Operating System, 3) Organisation Structure, and 4) Capability and Capacity.

Fast Scan, its four key dimensions, and the use of up to 40 detailed review dimensions enables a structured programme to be developed to create a bespoke and focused development plan. Importantly a comprehensive set of benchmarks against each of these review dimensions is available and can be used to make a comparison against competitors and other industries.

In summary the FTI Consulting six key levers and Fast Scan methodology assist in the design and development of a bespoke supply chain solution to meet the specific challenge and needs of our clients.

Delivery is based on the use of a detailed, holistic questionnaire and focused in-depth interviews with key stakeholders of the business. This ensures the focus of all activities is on the most important risks and opportunities across the main levers available for improving the supply chain.

A CASE STUDY

A European consumer goods business with production plants across three countries needed to realign production capacity due to changing economic conditions. With our support the company decided on three key actions;

- 1 Significantly increase capacity in country 1, improving operational efficiency;
- 2 Downsize operations in country 2, reducing complexity; and
- 3 Close the plant in country 3, optimising the future physical footprint.

This decision required a broader set of decisions, consultations and negotiations elsewhere across their supply chain. Management now had to consider the implications of closing production on, among others;

- 1 Inventory build and storage location;
- 2 Manufacturing location;
- 3 Supply chain capacity and capability;
- 4 Sales and operations planning to meet continued demand; and
- 5 Vendor reduction and selection.

The decision to close the production facility in country 3 was particularly sensitive given the social package required, alignment with unions and workers' council as well as compliance with other regional regulatory requirements. As a result, a broader strategic assessment of alternative options was needed to ensure acceptance from all involved stakeholders.

Changing the supply chain and optimising the manufacturing footprint required a detailed analysis and understanding of alternative options and their individual impact on one-off and ongoing operating costs. It is important to create a detailed business case that addresses both the cash flow and EBIT(DA) implications for each scenario. These may have to be presented to unions and other officials alike. It is not uncommon to have to consult and negotiate with works councils at both the local and regional level as well as local governments, informing them of the strategic and financial rationale for the decision.

Using the levers outlined above we assessed the optimum footprint options based on a consideration of market requirements, forecasted growth rates and a robust and scalable logistics concept for the European market. We were able to assist them in identifying the necessary inventory levels required to support product availability before the plant closure and line transfers to ensure continuity of supply during a period of significant change.

Further, we were able to assist management with a full cost benefit analysis, assessment of potential one-off costs and a business-wide risk assessment. We then supported management with the implementation and were able to ensure that the transfer was delivered without any business interruption, even during the construction of a new extension to contain the transferred capacity.

Finally, we were able to develop a range of initiatives to improve the ongoing efficiency in the remaining sites further helping to reduce future operating costs.

Supply chain management is a complex and critical business enabler with increasing importance due to ongoing globalisation and increasing product and supply chain complexity. FTI Consulting is able to support our clients with a robust and successful methodology which allows clients to manage risk and realise significant upside potential.

FTI Consulting supports our clients as consultants or interim managers depending on the individual situation and needs. We provide a pragmatic and deliverable supply chain solution which will generate sustainable EBIT(DA) and cash advantages.

FINALLY, WE WERE ABLE TO DEVELOP AND QUANTIFY A RANGE OF ROBUST INITIATIVES TO IMPROVE THE ONGOING EFFICIENCY IN THE REMAINING SITES, FURTHER HELPING REDUCE FUTURE OPERATING COSTS.



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AT THE CRITICAL TIME™

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