

Tune up your supply chain to become more flexible:

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Five tips for the fluctuating market situation

Economic prospects have deteriorated since the summer and the future outlook has been further clouded. Some of our customers have turned to me for my own views on the development of trade and market conditions. Instead of making guesses about economic trends, I have advised our customers to develop their own supply chain and purchasing and inventory control so that damages can be minimised –even in rapid economic swings. In practice, this means focusing on business intelligence as well as determining and changing the dynamics of your own supply chain.

In this article I have compiled five essential tips for increasing supply chain reactivity and flexibility:

1) **Keep an eye on changes and try to react quickly and correctly**

Although predicting the future is especially difficult at the moment, valuable time is nevertheless lost by many trading companies because they fail to react in time to changes that are already underway. In an uncertain market situation, it is vital to monitor sales developments continuously and to react to changes immediately.

Measuring forecast bias at different levels is one way of identifying changes. By monitoring the proportional difference between forecasts and sales, it can be quickly observed if sales start to differ significantly from previous estimates in certain product groups. At the practical level, one must also be able to quickly determine which product groups, price groups and/or brands are most affected by the sales changes.

Monitoring alone is not enough, though. Observations must be used to make quick changes both to purchasing plans and marketing and pricing decisions as soon as it becomes clear which products are at risk of accumulating overstock. The time between observation and decision must be even shorter for short life cycle and seasonal product segments.

2) **Identify change-sensitive products and suppliers**

The forecast sensitivity of products in trade supply chains varies significantly. For some products, the realised and forecasted sales can differ by dozens of percentage points without a significant effect on supply chain efficiency. For other products, even the slightest forecast error can cause product shortages or significant overstock.

As a rule, the longer the planning period, the more accurate and longer-term forecasts are needed. This applies, for example, to many in-house brands and imported container goods. For these products the planning period – i.e. order–delivery time – can be several months to a year.

It is crucial to identify the most change-sensitive products and suppliers. More time and effort should be invested in monitoring and planning these than reviewing products that are less forecast-sensitive.

3) Reduce fluctuation risks by improving flexibility

Once the risk products have been identified, the next step is to consider ways of reducing their risks.

Many traders have achieved considerable savings on purchase prices by bypassing European wholesalers and purchasing directly from manufacturers operating in the Far East. However, as uncertainty increases, suppliers closer to home offering shorter delivery times and smaller purchase batches can prove to be a more affordable supply source due to reduced inventory risk. As predictability weakens, the number of supply sources should therefore be increased where possible, and the uncertainty of demand taken into account in purchasing decisions. In practice, the main supply flow will come from further afield if goods can be obtained at reduced cost. However, only relatively certain volumes should be purchased from afar, and safety stocks should not be created based on the uncertainty of lengthy delivery times. The adequacy of goods coming from the main supply source should be continuously monitored and additional orders placed with a more local supplier, as necessary, in order to guard against product shortages.

Using several sources of supply enables safety stocks and the risk of forecast error to be significantly reduced without increasing purchase prices disproportionately.

4) Different customers react differently to market changes

Changes in consumer behaviour occur at slightly different times and at varying degrees at different stores. This is essentially because different customers react differently. As uncertainty increases, it becomes increasingly important that, for example, seasonal products are not allocated en masse to a single point of sale. In the worst case, the outcome can be overstock at some stores and shortages at others. This is, in effect, the same problem continuously encountered with weather-sensitive products, regardless of economic trends.

It is easier to control stock based on realised sales if, at the start of the sales season, only the amount that can be sold with certainty is delivered to the point of sale and the remaining products are withheld for centralised distribution. As the season progresses and sales develop, a more accurate view of the total sales of each product at each store can be determined. Monitoring the realisation of sales is especially important in change situations – whether due to economic developments or local competition.

5) Learn the behaviour of product groups in relation to each other

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In trade companies, especially in wholesale, different product segments often have quite independent profit responsibilities, and valuable internal information sources often remain untapped in companies with extensive product ranges. Market changes are usually seen in different product segments at different times. For example, in the construction materials segment, weakened demand for plumbing equipment is normally followed by a subsequent drop in electrical equipment sales. By analysing previous changes, the reaction sensitivity and order of reaction of different product segments can be seen. Observed changes in the sales of a given product segment should be utilised to minimise the supply chain risks of product segments that are more slow to react.

The starting point for writing these five tips for controlling supply chain risks during economic swings was the possible onset of economic recession. However, the same guidelines also hold true in the event of an upswing. Rapid positive changes in demand can easily cause product shortages, especially if suppliers have adjusted their capacity to the recession. In such an event, traders with a flexible supply chain and rapid reaction ability can increase their sales faster and with a better service level and gain market share from the slowest competitors. Whenever predictability weakens, that is the time to invest in reactivity and flexibility!

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