Re-understanding “integrated” supply chain

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Somewhere along the way, it became the norm to give up control of component supply and call it “business improvement.” Re-think the standard mode of buying stuff from others if you can do it yourself.

In the last couple of weeks I have had a coincidental series of encounters concerning business problems and business successes all centered on supply chain challenges. In short, they boil down to a single observation. Of these encounters, the businesses that are succeeding have simple control over their supply and those that are struggling have lost control.

One business in particular is losing business and is battling to retain contracts because on-time delivery performance is poor. Without explaining torturously complex interactions of process, the bottom line is that product is not built on time because component parts or critical information is not on hand when necessary.

This same business won a great many of its current contracts several years ago when on-time delivery was some of the best in the industry. What changed? The business jumped on the popular trend of establishing an “integrated supply chain” to save operating costs and decided to outsource much of the work it had been doing in-house.

Most of the lessons to be learned in doing so have been experienced, from short supply, to excessive expediting costs, to quality issues, to conformance problems, etc. Now, competitors with better on-time delivery are bidding to get business back.

Another business is further along the learning process. It is winning back long lost market share because it has, as it explains, “vertically integrated” the production of its product. In this case “vertically integrated” means that it produces every component of its own product. Supply is limited to materials and commonly available parts. Every custom component is manufactured in-house.

The result of this integration is that they have near complete influence or control over the manufacture and availability of every component part and the business’ quality and on-time delivery tightly controlled and predictable. Does it cost more? Well, they are winning more business because of it, so is it bad if it does. What if it practically doesn't?

Some time ago, I talked with a business owner of a medium-sized business in the Midwest United States. He explained that his business would never need or desire to move either production or supply to a "low-cost" country. The reason is that his business produces an enormous variety of standard and custom vinyl and plastic products for a varied market.

His supply consists entirely of materiel. All of the tooling and design work is done in-house. His success hinges upon his ability to rapidly provide custom products to customers. If he moved any part of his operation to another country, he would lose that advantage.

Finally, I re-engaged some colleagues at a business with which I worked a while back. It is a large, global corporation that is re-organizing and letting go of some long-time products and brands at the same time. They are no longer performing.

According to the explanation provided to me by of some of the personnel who work on those brands, the brand distinction has evaporated as more and more of the product was moved to low-cost countries and subsequently became just like the other products that are designed and manufactured in those countries, all in the name of reducing production costs by standardizing (using commonly available or already produced-by-someone-else) design elements.

Granted, the personnel being sold off might be a little jaded and biased by their experience, but their insights might also be right on target. I've witnessed some of the phenomenon myself.

As I wrote above, these encounters all seem to have a similar relationship. Those businesses with strong and exclusive control over their supply are successful. Those that have given up either control of supplied components, or turned over design and development of those components to suppliers that do not share the same vision of quality or on-time performance are losing.

Reflecting on my own experience, I see a major misunderstanding of successful supply chain management that has occurred across much of U.S. and some European product development industry. Outsourcing became the trend, but the reason was misbegotten by many.

There are many reasons to outsource component elements, even designed and developed elements, to others. If the reason is valid then it categorically falls in the context of someone-else-can-do-it-better. When our products evolved to include electronics or software and firmware, some of us found it better to get those elements from others than to learn it ourselves, for example.

We tend to get into trouble when we decide that someone else can do something we have historically done for ourselves, cheaper and just as well as we can ourselves. This is especially the case if a boat ride is involved.

The calculation usually begins with a consideration of material and labor costs, and an assumption that quality will remain the same. If those business leaders are truly conscientious about the calculations, then they also take into account the increase in inventory and lead times for components that are in transit from the supplier to the production site. Rarely do they include calculations for quality issues, late delivery, and expedite costs either to the supplier or involving customs. Those calculations never seem to consider the cost of lost business due to on-time delivery or quality degradation.

Why do we accept the assumption that a supplier would have the same vested interest in quality or on-time delivery that we do? Certainly some suppliers do, but they are often closer to home, in greater demand by those who truly value supplier performance, and they are not usually the ones making those production cost calculations for outsourcing so attractive (they cost more).

Somewhere along the line, outsourcing became a very popular trend, but many of us forgot that the key to successful outsourcing is integrating. In other words, outsourcing works when the suppliers are just as much a part of the business as if they were part of the same company.

Consider this: your small or medium-sized business uses the same supplier that the automotive industry does. This is great because the same stringent protocols to ensure quality for these very big companies with very great leverage are also ensuring the quality of your components. However, when the automotive company needs to expedite a major order that taxes the supplier's capacity, what's going to happen to your order?

Because the automotive company has integrated that supplier, and made the penalties for failing to fulfill an order very significant, your order might be the one that is not fulfilled perfectly according to contract. Your only defense is to also integrate your suppliers.

Integrating is a problem, however. Most suppliers don't want to be integrated. They want to be masters of their own destiny. If we want to integrate a supplier, we must guarantee a great deal of business and make the promise of indentured servitude so attractive that it actually sounds like a good idea. That is a very difficult thing for any but the largest companies to do, and it is something that many large companies don't do well.

So, what we get is outsourcing without the integration and our fate is no longer under our own control. The security blanket that many companies turn to in this situation is to leverage business across several suppliers so that if one falls short all of production isn't held hostage. Quality and price are influenced by continuously competing these suppliers against each other for more business.

It can be effective, but again, generally for the largest businesses that have enough volume business to be able to play games with suppliers. However, it's not a very good way to build a positive, loyalty-based relationship with suppliers. Also, it generates a great deal of work for your supply chain function in the business, a very great deal of work. That extra overhead rarely makes it into the business calculation that said that money would be saved by outsourcing.

Managing a complex network of suppliers requires a large team of highly skilled supply chain professionals and a strong system of forecasting and tracking production demands. Don’t forget the continuously travelling supplier quality team you must have to work with existing suppliers to meet quality expectations as well as qualify new suppliers.

So, what’s the solution? Well, if the problem is that a poorly performing supply chain system is impacting business then there are several options.

1. Simplify your supply chain as much as possible
2. If you must outsource custom components, choose carefully
3. Build a relationship with suppliers, one that is based upon dependability

The last suggestion is the one most overlooked. It is also the one that smaller businesses struggle most to accomplish simply because they don’t have the leverage to influence suppliers in their favor. Sharing profit rewards with a supplier is not popular among many business administrators, but somehow, if we must outsource, to ensure performance, we must find a way to answer the following question.

How do I make it in my supplier’s best interest to always come through for me?

Sometimes that means that small businesses engage small suppliers, where the scope of the business at stake has a great deal of leverage with that supplier. This can be mutually rewarding. Sometimes it means that the relationship is as much personal or value-based as it is business-based.

Regardless of your organization’s situation, take a good look at your supply chain and supply strategy. Are you following a trend, or are you truly getting the right value for your product? Don’t outsource unnecessarily. Don’t forget to consider the wide array of hidden costs that come with outsourcing. If you do outsource, be very particular about building a strong relationship with your suppliers. The more integrated they are with your success, the better they are likely to perform.

Stay wise, friends.

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