

Viewpoint

What Do Customers Want?

Two weeks ago, our household received a letter from our bottled water delivery company informing us about the less frequent deliveries in order to increase the company's "operational efficiencies." With that change, they were advising their customers to order and carry enough bottles of water to get by for 4 weeks instead of 3. I could understand that the increasing "operational efficiencies" meant cutting down on delivery cost, drivers' payroll, stock carrying costs (which we would assume in a two bedroom condo) and / or delivering to more customers with the same amount of fleet with less frequent deliveries. What I kept on wondering, though, was what my (i.e. the customer) gain from these operational efficiencies were.

In theory, network design studies are mostly sought by upper management to gain similar operational efficiencies and financial savings. However, in practice you can only gain so much until you lose your customer's business. This was exactly why we start out asking our clients "Who are your customers?" and "What do they want?" in a network analysis study.

The effort should result in a plan that will enable businesses to achieve their profit goals while establishing necessary distribution channels, positioning appropriate inventory, and utilizing the most competitive transportation modes all with the customer's needs and tolerances in mind. The ultimate goal is to achieve the balance among "right product, right time, right place and right price" and thus create customer value that will make you win the game.

Here is the "customer-focused" businesses' network analysis plan:

1. Define business model:

Lay out your business model on the table. Define the business you are in and your business' value proposition. The determination and evaluation of alternative solutions will be different for a company that aims to be a cost leader versus another one that aims to differentiate.

Create a flow chart that defines your current business model. This flow chart should show the current supply chain (or different supply chains) starting from your suppliers to your customers. Elaborate on each step of your supply chain; identify the characteristics of each node such as products, suppliers, distribution nodes, transportation partners and customers.

Today's businesses should have their focus on customers. This helps managers to recognize their "most valuable and profitable" customer segments (refer to Pareto Analysis) and concentrate their efforts into the appropriate channels.

This study should reveal where you're coming from and why you do what you do. Visualizing your business model on a chart or map will also help you to identify value-added versus non-value-added activities at a high level.

2. Define objectives and constraints:

Define where you want to be in the future. You can determine your business' objectives reactively or proactively. You might want to just improve your services or financials, prepare for forecasted growth or you might even plan to

shift the direction of your business 180 degrees. Regardless of how minor or drastic these objectives are, they should be quantified in each instance.

Equally, you have to consider all possible constraints - financial or legal – that encircle your business as you aim to improve your customer service. If you just recently renewed your warehouse lease or carrier contract, you should either take the cost of getting out of these contracts into consideration or assume these factors are preset.

This planning phase will require a strong collaboration among divisions especially among sales and marketing, operations and finance along with warehousing and distribution. Without the input of all these departments, you may end up with a plan that will get you there cheaper, but there may not be any customers when you get there.

3. Define your customer service requirements:

A business should already have clearly defined customer service metrics definitions and goals to measure its performance. As you can only manage what you can measure, you also can only model what you can measure.

Some of the quantitative metrics you should consider are:

- Order and delivery accuracy
- On-time delivery
- Order fulfillment lead time
- On-time shipments, delivery
- Fill rate
- Days of finished goods inventory on hand
- Cycle times

Quantifying and calculating the customer service levels using a logistics network model are not a tricky as it seems. Any service criteria related to shipments or deliveries will be quantified through carriers and lanes between

nodes created within the model. As an example you can put a constraint on the distance from a distribution center to a customer or you can limit travel time for specific lanes to ensure on-time delivery.

The carrier types also affect delivery service levels. With a wide array of carriers from parcel to private fleet, models can measure and compare cost of the “required” speed of delivery and returns. For example to deliver to a customer who expects your product to be there within the next week, you can set your maximum distance to 700 miles and choose a truck load carrier to consolidate weekly shipments and increase utilization.

In the model, inventory levels and turns will help you to calculate service reliability measures. Limiting or expanding the capacity of each storage location will also change the inventory calculations. Understanding the position of the inventory in the supply chain is also critical for superior customer service and minimum total supply chain cost. For example allowing the model to move critical items from all available locations and limiting the slow turning and less critical items to few locations will help you keep your service levels high while keeping inventory carrying costs low.

You should also define your customers’ tolerance level or their sensitivity to any service level changes you might make. For example, it is important for you to identify whether your most dedicated customers stay with you because you deliver your product the next day or just because your product is beyond their expectations and they are willing to wait a few more days. There might be some customers who think home water delivery service is much better than carrying gallons of bottles from the grocery regardless until you ask them to spare another room to store more bottles.

You can define qualitative customer service factors as well. You should pool the knowledge and experience from all customer contact points about their expectations. Some of these

requirements such as customizations or “no question return policy” will effect your network design decisions.

Keep in mind that this study is not a decision between cost and customer service. It is about knowing what your customers want and how they want it and delivering exactly that in a cost efficient and effective manner. You should not go lower than your customers’ expectancy and lose “profitable” business in order to keep your cost lower. With that perspective in mind at end of the day, maybe I am not a profitable customer for our water delivery company anyway.

4. Modeling the current network

After planning phase, load your data to build the current distribution network. This will be your baseline to compare against any alternative scenarios. Logistics network modeling tools will not only to help you model the cost structure of your distribution network, but you’ll be able to distinguish important factors that will impact your service levels.

Aggregation of the data is an important part of this process. You should use the customer segments you identified in the first two steps to facilitate the aggregation process so that each segment requiring different service levels will be distinguished. Product aggregation should reflect the shipping and handling requirements by each customer segment.

5. Develop and evaluate alternative networks:

When you develop alternative networks, you should compare them not only based on financial returns but also based on the objectives and constraints you defined in steps 2 and 3. Through this analysis, you should strategize how to get to your objectives in 5 to 10 years.

The marketplace evolves day-to-day with product life cycles shortening, customer service expectations increasing without stopping, competition getting fiercer by the minute, and economic conditions. Therefore, Logistics Network Design should not be conducted as a once-in-a-life-time study, but rather as a continuous effort as executives and managers keep an eye on improving the customer service levels to stay financially competitive

Back to my story with the delivery of water bottles. I wish the company had convinced me that changing their delivery frequency was adding value to me (remember I am the customer). Unfortunately, my current water delivery company did not take a “customer in” focus strategy. It was about them improving their cost at the expense of customer satisfaction. Discovering all the other delivery companies made the same move added to my disappointment and eventually I decided to stick with my current company. However, until I move to a bigger house I order only the number bottles that I can fit into my tiny condo and a week or two later I call customer service and ask for additional delivery. Well, that of course, until they figure out my scheme and start to charge for my “botching” their operational efficiencies.

“Being on par in terms of price and quality only gets you into the game. Service wins the game”.

~Tony Alessandra

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