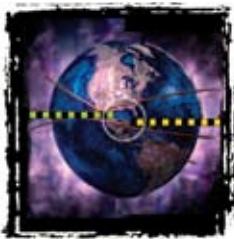


# The Three Dimensions of Distribution Excellence

*To achieve the potential of distribution excellence, companies need to think outside of the box.*

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What allows certain companies to deliver best-in-class distribution performance while others turn in only average performance or fail altogether? From our work in this area, we've observed that

the leaders in distribution—those that deliver on a defined set of quality and service levels at the best possible cost—consistently think outside the box. They push their competitiveness to an efficiency frontier, achieving a 15 to 30 percent distribution cost advantage over competitors while delivering equal or better service levels. Some of these leaders go a step further and leverage successes in distribution optimization as a catalyst to improve performance across the entire value chain—from demand planning to logistics—both to improve the top-line and unlock additional savings.

We characterize the approach as “3D” outside-the-box thinking because it requires the following three dimensions: Benchmarking beyond industry boundaries, challenging preconceived views, and triggering a chain reaction in supply chain optimization.

## 1. Benchmarking Beyond Industry Boundaries

Solid distribution requires first establishing an accurate picture of your distribution competitiveness vis-à-vis true peers. The leaders establish a competitive gap assessment whereby they neither underestimate their distribution capabilities (devoting valuable resources without an adequate

return on investment) nor overestimate their performance and thus get lulled into a false sense of complacency.

The leaders understand their true peer group and compare their distribution performance against these peers. Determining which companies are your true peers, however, can be difficult. It is not unusual to find after years of benchmarking that you've been comparing performance against the wrong peer group. For example, a firm in the motor-vehicle sector we studied historically benchmarked its after-market distribution against the automotive industry and ranked its cost-to-serve in the top 90th percentile. But was this motor-vehicle firm really performing in the 90th percentile? We didn't think so. This company, like many others, was mistakenly defining its peer group largely by its overall business profile rather than by its after-market business requirements. When benchmarked against firms in other industries with similar distribution requirements—mid-scale apparel retailers and after-market parts firms—the company discovered that its distribution performance lagged well behind others.

Rather than rely on proxies for selecting a peer group for benchmarking such as “what industry do I play in?” or “who are my direct competitors?” distribution leaders use segmentation metrics to identify the correct benchmark peer group. The segmentation variables should have sufficient detail to (1) capture the key operational dimensions that characterize the underlying distribution requirements and (2) align with the company's overall business strategy as well as customers' needs.

## 2. Challenging Preconceived Views

In order to achieve breakthrough distribution performance, companies need to overcome entrenched biases. Often, organizational biases lead to sub-optimal decision making across two critical components of a distribution solution: determining the right level of technology and deciding on keeping distribution in-house vs. outsourcing (make vs. buy). The right distribution solution thus requires an objective and systematic assessment of both components: technology and a make-vs.-buy assessment. Let's discuss each:

**Matching technology to requirements.** Distribution technology includes a holistic suite of warehouse automation, material handling systems and warehouse management system (WMS) software that collectively enables distribution, from product receiving to shipping. Determining the appropriate level of distribution technology—or whether or not you need it at all—requires considering several trade-offs, including capital investments, productivity, and longer term flexibility.

Exhibit 1 depicts the key criteria to inform the degree of flexibility vs. the degree of complexity. Note that the optimal configuration may not require a homogeneous solution across the entire distribution network. Certain network nodes (or distribution centers) can have a less automated, less technological setup while others can have a more automated high-tech configuration.

**Performing the make-vs.-buy assessment.** Distribution gaps can be closed by tapping into the external market for key capabilities. Third-party logistics providers (3PLs), for example, can help reduce costs and allow companies to offer differentiated services. Finding the optimal make-vs.-buy balance and then executing an outsourcing initiative requires the following mindset:

- *Adopt a strategic view.* Before either dismissing out-

sourcing as too risky or embracing it as a silver bullet to achieve best-in-class competitiveness, systematically weigh the risks and the benefits. The three main questions to answer: Is product distribution a core competency? Is there a cost advantage to outsourcing? Is there a third-party provider that could handle the job?

- *Understand the 3PL market trends and capacity early.* Third-party logistics provider capacity must be understood at both the industry and individual levels. Performing a capacity assessment early on—before launching an official supplier bid process and due diligence—can save significant time and resources and better inform downstream bargaining power, which is crucial to capturing cost advantages from outsourcing.

- *Recognize technology differentiation in the 3PL market.* Although all large integrated third-party logistics providers possess broad capabilities and can arguably play across the entire technology spectrum, many tend to have a technology “sweet spot.” Rather than go with the low-cost or the most high-tech provider, look for 3PLs that have solutions and technology aligned with your distribution requirements.

- *Consider strategic fit in the due-diligence process.* Some questions to ask in this regard include: Are my distribution requirements and capabilities a focus area for the 3PL? How will my business affect the provider's overall revenue base? Is my industry vertical a key sector for the 3PL? Answers to such questions will not only provide a stronger bargaining position but also ensure that the 3PL continues to be responsive and flexible after the contract is signed.

## 3. Triggering Chain Reaction in Supply Chain Optimization

Early successes in distribution can be a catalyst for change across the broader supply chain. Transformational change

usually requires first getting past organizational impediments such as silos where key decision makers sit in different functions and there is very little collaboration among departments. Focusing on a particular activity such as distribution can create a “wedge” to break down organizational and functional silos and drive broader transformation across the entire supply chain—from demand forecasting to inventory and freight management.

