I recently presented to a group of supply chain managers in Buenos Aires, along with another educator from Spain and two practitioners from Argentina. The conference organizer closed out the conference with a question-and-answer period during which the speakers were assembled as a panel to answer questions from the audience. The first questions that we got were relatively easy since they related to what we had talked about during our presentations. Towards the end of the session the moderator asked us the most difficult question: “If you had one thing to tell these supply chain managers, what would it be?” This question would not have been hard to answer had we been warned in advance that it would be asked. Since we weren’t, we all looked at each other stupefied, searching for what to say. Always willing to offer my opinion, I finally spoke up and said that I would give it a try.

I said that supply chain managers should be embracing not resisting complexity and risk. I added that the most successful companies are those that are best at managing complexity and mitigating risk. This is what makes them competitive. I then went on to elaborate on my answer.

Would I have given a different answer had I known the question in advance? Not really. I think it’s still a good response, as I discuss below.

Complexity and Risk
Not Necessarily Bad
As I pointed out to the audience, I’ve attended many conferences and heard my share of supply chain managers complaining about product proliferation in their companies—as if this were a bad thing in and of itself. Companies offer myriad products to generate more business, and that should be a good thing if done well. They also open more sales and distribution channels. And while this further adds to complexity, it is done to increase revenues and sustain profits.

Other managers complain that demand forecasts are never accurate enough. They mistakenly believe that if forecasts were perfect, that would be the solution to all supply chain problems. Hearing this, I point out that while companies should do all they can to increase forecast accuracy, the forecast is ultimately limited by uncertainty in demand. Accuracy is probably not going to get that much better and may even get worse. Successful companies continually take on more risk, such as by introducing new products and entering new markets. And that means customer demand might become more uncertain, and forecast accuracy worse.

The Risk-vs-Reward Curve dictates that the more risk one takes on, the greater the potential to reap big rewards. Furthermore, the riskier the business/industry, the higher the operating margins and profits generated over the long-run. In fact, companies that don’t continually take on new risks are likely to die over time. Thus, inaccurate demand forecasts and risk are not necessarily bad things.
Managing under Complexity
While adding to complexity by marketing more products and services to more markets and increasing sales channels might generate more business, supply chain managers should not agree to increase complexity without making sure that the decision to do so is sound. However, simply resisting complexity is usually counter-productive. Managers should help make sure that increased complexity is profitable. One way to do this is to apply simple solutions—usually enabled by technology—to manage complex supply chains. Another is to help the corporation understand the impacts of increasing complexity, especially on supply chain costs, inventories, and profits.

Simple solutions to manage complexity often involve segmentation in a balanced “Goldilocks” way—that is, with not too many segments, yet not too few, but “just right.” Treating customers, products, and suppliers in one way is usually not optimal; yet treating each one completely different is too unwieldy, cumbersome, and inefficient. Supply chain managers should play a major role in crafting the most profitable and manageable menu of “packaged services” to be offered to customer segments. Similarly, they should ensure that suppliers and products are efficiently segmented and managed.

Complexity generally increases the costs of doing business in ways that are not always easy to assess. Marketing and sales management want to increase complexity to drive more business. Yet they often do not know the impact on costs and inventories…or profitability. Supply chain managers need to conduct detailed analyses to help their executives decide on which complexity changes to make. However, using product proliferation as an example, profitability analyses need to take a “corporate” view and incorporate the importance of product loss leaders, rather than jumping to a conclusion that all unprofitable products should be terminated.

Coping with Increased Risks
Supply chain managers need to help executives understand the impact of taking on increased risk as well as the risk management mitigation techniques available. With regard to the first point, doing whatever it takes to improve forecasting accuracy is one way to both understand and minimize the risk. More importantly, supply chain managers need to assess and analyze the full impact of increased risks on costs, inventories, and profits. This might involve the use of scenario planning in which detailed cost and inventory analyses are conducted under a variety of business situations.

Supply chain managers also need to understand the demand uncertainties associated with the risks and then apply risk management methods to mitigate them.

Supply chain managers need to understand the demand uncertainties associated with the risks and then apply risk management methods to mitigate them. This might involve segmentation to apply more effort on the most important business segment; it could also mean the deployment of supply chain “buffers” such as safety stocks and excess capacities. For more on risk management see my SCMR Insights columns, “Risk and the Planning Process (October 2009) and “How Buffers Can Mitigate Risk” (April 2008).

In short, I could have given a lot of other advice to the supply chain managers at that conference. But based on the arguments I just put forward, I’m convinced that this was the soundest advice I could have offered. By following it, managers can take a giant step toward making their companies very competitive and successful in the long run.