

When the Silo Walls Come Tumbling Down, Only Then Can Supply Chains be Truly Optimized



UPS Capital®

Our Insight.
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With the emergence of free-market economies, the competitive marketplace accelerated.

Large companies – and the banks that serve them – are often organized into “silos.” These are teams, divisions, and units within the company or bank that were set up in the past to serve a particular function or client. While the silo approach may have worked efficiently for domestic supply chains, it works less well for today’s globalized supply chains. Instead, companies should break down the divisions created by these silos to achieve optimized physical and financial supply chains.

“If it’s not broken, don’t fix it.” For years and years, this adage has been applied to supply chain management, and for a long, long time, the adage made sense. Corporate supply chains weren’t broken. In fact, they operated just fine – especially decades ago as companies sourced materials and sold finished products all within the same country. This made supply chains easy to manage. Goods moved rather efficiently from manufacturing facility to warehouse to store shelves, and the goods arrived on time and intact most of the time. Yes, the payments for the goods often lagged the actual movement of the goods, but this “glitch” wasn’t large enough to cause a great deal of corporate heartburn.

In other words, the supply chain wasn’t broken, so why fix it? Supply chains were short and intra-country. The company operated within the legal jurisdiction of a single country and currency issues didn’t exist. The straightforwardness of the supply chain ensured few friction points.

But then globalization occurred and supply chains began to elongate. With the emergence of free-market economies, the competitive marketplace accelerated. New sources of low-cost production became available and companies began to realize the economic advantages of sourcing and producing goods in other countries.

Companies began to close their domestic manufacturing facilities and internationally outsource their manufacturing – either in its own plants or via an outsourcing partner. In many cases, companies ignored the impact to its capital structure caused by these necessary operational moves. This single decision – outsourcing manufacturing to other countries – has had, and continues to have, profound impacts on how companies are structured, organized, financed, and

how they manage their supply chains. And the aftershock of this monumental change is just now being felt. Indeed, we are at the tip of the iceberg when it comes to dynamic changes in how supply chains are managed.

The adage, “If it’s not broken, don’t fix it,” no longer holds up. In today’s globalized economy, the new mantra is: “If the entire supply chain (physical and financial) is not optimized, then your company is not optimizing its financial performance.”

Optimizing today’s global supply chains is a tricky endeavor and requires companies to commit themselves to a new organizational structure, and thus represents a paradigm shift. It also requires a holistic view of the supply chain – a view that includes not only the movement of goods but also the movement of information about those goods and the deployment of capital across the entire global supply chain.

Unfortunately, when it comes to supply chain management, today’s corporation is organized in a way that prevents true supply chain optimization. And the banks and logistics providers on which today’s corporations rely also are organized in ways that inhibit the convergence of the physical and financial supply chains.

The organizational culprit? Silos. The teams, divisions, and units within companies that were built decades ago to accommodate domestic supply chains have since become cemented inside corporate cultures. Breaking down the walls between these silos is critical if a company is to optimize its entire supply chain.

While the “old” silos may seem to be efficient, this is only because they are still being quantified and qualified on yesterday’s metrics. In reality, not only are the silos in a state of disrepair, but the entire supply chain is broken. Unfortunately, many companies have not yet determined how to measure the effectiveness and efficiencies of their new global supply chains. So, the silo walls remain thick and supported by well-entrenched company politics and old indices.

A Historical Look at Corporate Silos

Before a company’s management team can begin to travel down the path of supply chain optimization, it first needs to understand the silos that exist within the organization and how those silos were created. Additionally, the management team needs to examine not only its own silos but also those within its external partners – namely, the banks and logistics/transportation companies that it utilizes for financial and supply chain services. Here’s a close look at each.

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Corporate silos

To understand the silos within a company, we need to go back to the previous example of the company that, years ago, sourced and manufactured goods all within the same country. To operate this domestic supply chain, the company created different divisions:

- Finance/Accounting
- Logistics/Transportation/Warehousing
- Purchasing/Procurement
- Operations/Manufacturing
- Sales/Marketing/Customer Service
- Research & development

For the most part, each of these individual silos was able to operate independently of the others. The purchasing/procurement team was responsible for obtaining the raw materials to produce the goods. Its focus: to get the best price for those goods. The operations team was responsible for assembling those goods into finished products. Its focus: to make the goods for the lowest cost possible. And the logistics/transportation/warehousing silo was responsible for getting the goods to market. Its focus: to use the lowest-cost transportation and warehousing options available.

Of course, there were always instances where the decisions by one unit impacted another – for instance, a delay in procuring raw materials delayed the start of production, which in turn delayed the transportation of the finished products to market. But when this supply chain was domestic, these delays were easily overcome.

Thus were born the silos. And just like sediment at the bottom of a river, the walls of the silos grew thicker and thicker over time.

Banking silos

Like any good company, banks structured themselves years ago to best serve their various customer sets, creating divisions and units that offered suites of products to meet customers' financial needs. For instance, banks created the following divisions:

- Commercial banking
- Investment banking
- Trade banking
- Treasury management/Cash management

These divisions focused on a certain size and type of customer and developed solutions, on a reactionary basis, to fill these needs.

And, decades ago, the establishment of these silos made sense. The commercial and investment banking divisions were created to cater

to that company described above that manufactured and sold goods in its home country. This division facilitated the deployment of capital to the company that produced and sold goods in the country of production. The company had very little inventory or accounts receivable that did not reside in its home country. The trade banking division catered to a completely different customer set – those few companies that conducted trade across borders, mainly the large multinationals. And the treasury management/cash management division handled payments for their customers along similar geographical and segmentation lines.

The banking silo walls also grew thick. Bank consolidation in the United States has weakened some of these silos for certain financial institutions, but strengthened them in others.

Logistics/transportation silos

Providers of logistics and transportation services structured themselves, just like banks, around the product portfolios that made the most sense for their customers. For instance, to help companies move goods intra-country, companies were created that provided ground transportation. For the most part, these companies stuck to their core competencies and geographies. Some companies catered to customers with air shipping needs, while other companies focused on ocean shipping.

Instead of departmental silos, transportation and logistics companies became highly specialized and, as a consequence, formed industry silos. This process created a highly fragmented and product-specific industry (which some say is in need of consolidation) that is similar to what occurred in the U.S. banking industry. Profits were solid and expansion occurred within their core areas.

For years all of these silos – in manufacturing, banking and transportation – worked just fine, that is until globalization.

The Travesty of Silos

Driven by the never-ending quest to lower costs and the increasing pressure to maintain margins in an era of competitive prices, company operations realized the advantages of manufacturing across borders and overseas. Almost immediately, costs began to drop and margins began to rise. Precisely the desired supply chain reaction.

Although this decision boded well for operations, the impact was felt across all the silos within a company. Longer supply chains create more friction points and no one escapes the affects of longer supply chains, whether an internal provider or an external supplier.

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In some cases the solution is simple: hire another vendor. One more vendor relationship to manage, to pay, and to bring into the silo won't matter. It will cost a little more in the short run, but over time, the company will squeeze the vendor and recoup those costs. The silo will easily make its numbers, because the numbers do not relate to the "new" global supply chain.

Meanwhile, for a medium-size company, the accounting/finance silo can no longer use the domestically produced goods as collateral for working capital. With the goods now made overseas and then shipped back to the home country, it's no longer as easy to borrow against those goods. After all, they now reside in a legal jurisdiction unfamiliar to the company's bank. So the accounting finance silo begins to rely on letters of credit to finance the trade deals, which is certainly a paperwork-intensive and time-consuming process. But, once the company gets to know its overseas manufacturing partners better, it'll force them to do business on open account, enabling the company to achieve better terms and lower costs. However, the move to open account actually takes away a source of capital for the supplier while also reducing fees that the trade bank silo was getting. So, the reaction is that the supplier increases its price of product to the buyer, and the vicious circle begins. The trade bank silo responds by seeking new credit products to replace the lost letter of credit income, and that silo begins to encroach on the commercial bank silo. Turf wars begin.

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Eventually, though, shifting costs back down the supply chain will no longer bear fruit. There will come a time when all of the silos will have achieved their own pinnacles of efficiency. The physical supply chain is close to such efficiency, especially in certain industries. However, the financial supply chain is behind the curve and banks are endeavoring to catch up. They are being driven by their customers to find ways to solve these issues, or they run the risk of being disintermediated. The industry is at an inflection point.

What is a company to do?

Bring Those Silo Walls Down: Can't We Just All Get Along?

There is a difference between an efficient supply chain and an optimized one. The silo approach described above certainly produces efficient supply chains. But the efficiency has reached a ceiling. The focus for the business community must now turn to supply chain optimization – marrying the physical and financial supply chains. This means bringing all of the silos together into a single organization. A CFO's role in a globalized economy has expanded and is ever more strategic. He or she is tasked with optimizing the deployment of capital throughout the entire order-to-collection cycle,

across multiple parties, in order to maximize shareholder returns. Simply shifting costs does not lead to efficiency; in fact, some would say it increases the risk to the company at large. Rather, the role of the CFO is to find ways to optimally finance the entire supply chain.

This is easier said than done, as these silos have existed for years. But it is imperative, if businesses want their supply chains to carry out the strategies that have been set. Here are six steps a company's management team can take to break down silos in an effort to achieve optimization:

1. Identify an internal champion to tackle supply chain optimization – someone who can begin to bring all of the silos together into a single, cohesive team. Our experience at UPS Capital has shown that CFOs are often the best individuals to tackle the role of supply chain champion as they have visibility into both the physical and financial supply chains.
2. Once the internal champion is identified, his or her first job is not to assemble a team representing each of the silos. Instead, the first job of the internal champion is to understand each of the silos and what motivates them. Each silo, as described above, has different objectives and different metrics for measuring success.

For instance, the operations and logistics/transportation silos are measured by their ability to reduce costs while maintaining quality distribution and meeting timely delivery schedules. The accounting/finance silo is measured by days sales outstanding and inventory carrying costs, which are impacted by the activities of the operations and logistics/transportation silos. But rather than asking one of those silos to change its ways – a “no-no” in the corporate world of silos – the accounting/finance arm simply begins to pinch its suppliers with more aggressive open-account transactions. And, of course, the suppliers respond by raising the prices charged to produce the goods.

Talk about a vicious cycle.

Indeed, while every single silo within a company might be firing on all cylinders and achieving goals, the company as a whole is still not fully optimizing its supply chain. Yes, the supply chain is efficient, but it is not as efficient as it could be, and the internal champion's job is to achieve optimization.

3. Once the internal champion understands all of these dynamics, then he or she is ready to assemble a single, cross-functional team that is assigned to pursue supply chain optimization. This

is easier said than done. Let's be honest, the bigger the company, the bigger the silos. In some cases, silos are so big they have their own management structures, cultures, and traditions that are not easily broken down. There can even be silos within silos.

4. One of the key steps the internal champion can take to break down the silo walls and get everyone on the same page is to change the team members' perspectives and change how their success is measured. Instead of being measured on the performance of individual silos, team members should be measured on a combination of metrics that represents the effectiveness and efficiency of all the silos. For instance, the accounting/finance team could be measured on how fast and economically the transportation/logistics team is able to move goods. And the reverse is true. The transportation/logistics team could be measured by the finance/accounting team's effectiveness in collecting payments. Indeed, there may be some steps that the transportation/logistics team can take that will accelerate the payment of the goods. That's teamwork.
5. Once the team is assembled and all working toward the same objectives – and once they understand how they individually impact the team's goals – then the champion and his or her team can begin to focus on the tactical execution of an optimized supply chain. The key thing to remember here is to take a simplified approach and start small. Do not – it is worth repeating -- do not try to optimize the entire supply chain all at once. Instead, pick just one trade lane, stock keeping unit (SKU), or supplier to optimize. But within that single lane, supplier, or SKU, look to optimize all components: the manufacturing, the procurement, the planning, the distribution, and the international and domestic transportation, even the sales and marketing processes should be challenged. Consider how the changes in one process could benefit or impair others. There are no limits to what should or could be considered. Look for ways to eliminate or improve existing processes. For instance, would using a third party logistics provider (3PL) be more efficient? Could assets be reduced? How could risk be mitigated so banking partners could more easily finance the global supply chain or inject funds sooner at better rates? Are distribution centers necessary when goods could be delivered direct to customers? If so, what are the best locations? Finally, you must ask the hardest questions: “What is the core competency of the business?” And, “What is my *raison d'être*?” Once you have addressed these important issues, start small and, “Go for it!”

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Then, when that lane, supplier, or SKU is optimized, move to the next and gradually take bigger bites. Ultimately, it is better to start small. Experience shows that companies attempting to optimize their entire supply chain all at once actually created more inefficiencies. They would have been better off with the status quo.

6. Finally, understand the positive and the negative ripple effects of this team's actions on the rest of the organization. The goal is to produce positive ripples while ameliorating negative ones. This will be a new way of thinking for team members who are used to operating within their silos and are not familiar with considering the impacts on other silos.

This new way of thinking and these six steps will reap invaluable rewards and result in a physically and financially optimized supply chain and will bring higher shareholder returns. And in a globalized world, those companies with optimized supply chains will – always – beat out competitors who simply have efficient supply chains.

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About UPS Capital

UPS Capital addresses the financial needs of the supply chain. Our services combined with the broad capabilities of UPS help enhance operations as well as improve bottom-line results. From protecting companies against the various risks associated with trade to assisting businesses with expansion into new markets, UPS Capital has a wide variety of financial solutions available for today's growing enterprise.

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