Understanding the market

The new economy has not only been heralded by changes in the way we do business, but also by changing expectations of the end customer. In many markets, customers are looking for products that meet their needs much more closely. And the accompanying service and experience levels need to match enhanced expectations too.

Despite the increase in customer sophistication, our work has shown that a common approach is to segment the customer base by account value. This may not seem an unreasonable approach as it is not unusual for 70% of sales value to be attributed to 5% of customers. However, what Pareto the ‘80 / 20’ fails to recognise is what the customer actually wants.

Shortcomings of Pareto in market analysis were recognised years ago by founders of the ‘Boston Matrix’, who showed how a product portfolio could be analysed in terms of market share and growth rate. The ‘account value’ approach to segmentation deals mainly at tactical and operational levels and hence while its primary objective should be to provide an understanding of the market that can drive business unit strategy, it commonly fails to do so. For instance, the move to call centres operating on standard processes fails to align with the most common reason for customer contact - the problem resolution of non-standard issues. Both customer and call centre operator are often left feeling frustrated. Resolution of such issues may mean that the call centre operator fails to meet bonus related performance targets while the customer issue has failed to be addressed. The account value based approach attempts to protect strategic accounts or customers from such poor service by providing a high degree of customisation and individual attention. However, research has found that the resulting cost escalation and reduction in account profitability actually increases the company’s dependence on the non-strategic accounts that do not receive this level of attention. Furthermore, in today’s volatile economic environment, the strategic accounts of today are not necessarily the strategic accounts of tomorrow. An account value approach to segmentation is becoming an increasingly ineffective mechanism for defining the market.

Supply Chain Management

Supply Chain Management (SCM) is a concept that has developed rapidly over the last decade. While individual components - planning, purchasing, manufacturing and logistics - have more developed roots, the integration of these functions both internally and externally across the supply chain is an ongoing challenge for organisations. Lack of integration makes putting the end customer first impractical. The supply chain becomes a hotch potch of different functional strategies that optimise individual business processes. Decision making at each stage of the supply chain is driven by different criteria. This sub-optimisation or matrix twist has been a common finding of our research. Figure 1 is an example from a FMCG supply chain which illustrates that supply chain decisions are determined by unmatched solutions. This has serious implications for supply chain management as it makes the goal of supply chain integration virtually impossible.

<table>
<thead>
<tr>
<th>Supply Chain Process</th>
<th>Supply Chain Decision</th>
<th>Determined By</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source</td>
<td>Which suppliers?</td>
<td>Raw material commodity type</td>
</tr>
<tr>
<td>Make</td>
<td>Which manufacturing site?</td>
<td>Product family type</td>
</tr>
<tr>
<td>Deliver</td>
<td>Which manufacturer warehouse?</td>
<td>Historically a function of order size in process of being divided by export paperwork requirements and customer account (arbitrary split)</td>
</tr>
<tr>
<td></td>
<td>Which customer regional distribution centre?</td>
<td>Product type and location of store to serve</td>
</tr>
<tr>
<td></td>
<td>Which products to which store?</td>
<td>Demographics of the store’s catchment area which drives layout and range decisions</td>
</tr>
</tbody>
</table>

Figure 1: supply chain sub-optimisation

While B2B solutions offer much to supply chain integration, automating processes that ignore end customer needs simply speeds up the creation of waste. Here we show how important it is to match processes along the supply chain so that internal and external capabilities of partners are in step with market segments.

By Research Fellow Janet Godsell and Professor Alan Harrison of the Centre for Logistics and Supply Chain Management
Furthermore, it calls into question the whole premise of supply chain management. Can a supply chain truly be considered to be ‘managed’ when it is an eclectic mix of functional strategies? Our research has found that in the absence of a designated supply chain integrator - such as logistics service providers who plan and co-ordinate material movements (3rd party of 4th party logistics provider) - there is little evidence of supply chains being formally managed. However, with the vast majority of organisations still organised on a functional or matrix basis, there is a lack of common purpose both within individual companies and across the supply chain which makes supply chain management very difficult.

**Customer responsiveness**

Despite these significant issues in both understanding the market and effective supply chain management, the solution may not be as difficult as it seems. What is required is a point of focus that can bridge the gap between the market and the supply chain and this focus is the customer. By placing the end customer first, market needs can be understood, and a supply chain strategy crafted to help partners work together to meet these needs. But such a customer focus is often lacking in practice. This is somewhat surprising as companies increasingly cite customer responsiveness as a key corporate objective. Based on our research, the key is to take an understanding of the market and associated customer buying behaviours, and use this to drive supply chain strategy. In turn, internal and external capabilities need to be aligned with this strategy. Adopting such a customer-focused approach to SCM suggests that customer responsiveness is about the identification and delivery of an appropriate supply chain strategy to meet the needs of the market that it serves. This is driven not by products, channels or markets but by behavioural market segments and is achieved by matching the desired strategy with the capabilities of the supply chain to deliver.

**Implications**

Matching behavioural segments with capabilities has major implications. Players within a supply chain should not only consider the match within their own organisation, but also consider matching capabilities across the entire chain. In practice, this means the formulation of a differentiated supply chain strategy. Some of our findings from our three year Engineering and Physical Science Research Council (EPSRC) funded project looking at Customer Responsive Supply Chains support this view. While the organisation characterised in Figure 1 segments its customers on account value, such a view is not reflected in either its internal or external supply chains. Two of its major customers may be characterised as volume driven (Volco) and margin driven (Valco) buying behaviour. Volco has two variants of volume - driven behaviour: everyday low price (EDLP) and discount. Both customers indulge in promotions, which we consider to be a further segment because of its disruptive effect on the supply chain. This results in four possible segments that need to be matched by four different strategic responses, summarised in Figure 2.

We have developed a road map to help practitioners understand current approaches to market segmentation, supply chain strategy implications and the associated capabilities currently within their organisation. The road map also considers development of a customer responsive ‘future state’.

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![Figure 2: A blueprint for customer responsiveness](image-url)