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Handling a Demand Dilemma

When unplanned events cause a supply-demand challenge, supply managers need a risk plan to handle allocation.

Risk management is a major concern of supply management professionals who have struggled over the past several years to keep supply chains moving during economic crises and natural disasters. Because of these challenges, there is a greater focus on adopting and developing various strategies and procedures for supply chain risk mitigation and disaster recovery programs. One major

demand with production capabilities to ensure effectiveness and efficiency in fulfilling customer orders. It's important for organizations to manage their demand planning and allocation strategy to achieve operational excellence. The consequences of a poor allocation strategy can be detrimental to an organization's bottom line, resulting in huge inventories, excessive lead times, poor asset utilization and unhappy customers.

has manufacturing plants spread across three locations in Europe and Asia, with account managers providing monthly sales forecasts on standardized templates. Based on the sales forecast, the supply management department scheduled production. In an ideal world, the allocation mechanism works perfectly.

However, the company faced unplanned shutdowns due to strikes, adverse weather conditions and unscheduled maintenance. These situations often paralyzed operations for weeks, straining inventory and causing demand to exceed supply. The problem escalated due to the company's large customer base, spot orders and wide variety of products. An allocation plan was established that would route shipments in the following order of priority:

- 1) Customers issued a pro forma invoice
- 2) Preferred customers
- 3) Spot orders.

For the first two categories, allocation was made on a pro-rata basis during unplanned events. While the business units agreed the plan was feasible, the challenge was determining preferred customers. The marketing and supply management

Good, consistent communication with customers is pivotal to maintaining customer relationships during difficult supply/demand circumstances.

risk area that requires best-practice guidelines — either as a stand-alone risk strategy or part of a larger enterprise risk management initiative — is a plan to allocate demand when unforeseen events cause demand to exceed supply.

The process of demand planning and allocation is central to manufacturing organizations. It is primarily a supply management planning process designed to accurately align

A leading European chemical company struggled with establishing procedures for demand allocation during uncertain times. Examining the company's challenges and the strategy it adopted to handle demand allocation may help other companies cope with unplanned demand issues.

Examining the Challenge

The chemical company, which we will call Company A,



organizations could not reach a consensus on which customers were preferred. The company tried using a customer segmentation approach, but the various business units could not agree on which customers were strategic, operational or noncritical, or the service levels that should accompany these segments.

In Search of a Solution

While the most obvious parameters for determining a company's preferential status are size and profitability of a customer relationship, Company A's supply management organization also knew it was important to consider legal and other forward-looking factors for an objective evaluation.

After several meetings with stakeholder departments, including sales/marketing and product management, the supply management organization developed a checklist for determining customer priority status. The proposed checklist would be the foundation for identifying preferred customers.

The following are key elements of the checklist.

Create customer contracts. Preferential customer status was assigned to customers with signed contracts. A contract was viewed as a way to reinforce trust and reduce risk by confirming both parties' rights and obligations. Having a signed contract in place also meant the company's terms and conditions would be applied instead of local rules and regulations, which generally favor the buying company.

Track contractual performance. In the past, there was no process for monitoring the contractual performance of a customer. In reviewing

contract compliance, the company realized many customers had not met their minimum obligation, which meant lost sales for the company. As part of its new allocation strategy, marketing directors implemented a quarterly periodic review of contractual performance and integrated buy/sell obligations into the company's daily operations.

Before the contract review process was implemented, the supply management organization had no visibility into the exact production volume the customer was contractually obligated to purchase — as the scanned copies of the signed contracts were dumped into a folder that not everyone could access. That obligation was not taken into account during production planning because the planning exercise was driven solely by monthly forecasts. Tracking customer contracts offered the organization the visibility it needed to better manage production. If a customer does not procure its minimum obligation over a certain period, its customer preference status is lowered.

Develop relationships. The chemical company knew that it was a sole supplier to some of its customers. This was an important criterion because, in the event of a supply breakdown, those customers would be most affected, leaving the company vulnerable to liabilities. In considering sole-source

customers, Company A realized many of its customer relationships were transactional. Often, customers did not share sensitive information (such as the fact that they sourced solely from Company A), so the company had no idea how many customers were in that category. The company believed this lack of information sharing was due to its transactional approach with customers, and that it needed to begin developing relationships that were more like partnerships.

The goal of developing better relationships was in keeping with a transformation strategy the company was undergoing, positioning its products across segments such as healthcare, agriculture and specialty materials. It meant a move from simply selling a commodity to better understanding the needs of customers and offering customized solutions to fulfill those needs, while generating a greater value proposition to clients. The intangible benefit was that Company A identified customers highly dependent on it for products and services.

Account managers were also instructed by Company A to be the eyes and ears of the organization and to collect information about customers that the company aggregated into a common database, creating a knowledge repository. Account managers were also required to review quarterly the customer account

plans (CAPs) and relationship maps, which were often neglected. CAPs provide important insights and visibility into the current and future levels of customer relationships.

Evaluate relationships.

Once supply management focused on building better relationships, the organization also decided to evaluate and rank customer relationships on a quarterly basis. The relationship ranking would take into consideration:

- Joint ventures
- R&D commitments
- Intellectual property issues
- Age of the relationship.

The evaluation also included forward-looking factors such as proposed expansion of the customer's operations, upcoming acquisitions and divestitures. These evaluations provided supply management with a solid foundation for allocating demand in times of supply risk.

This case study highlights the need for a proactive strategy to manage allocation during uncertain times. Designing the strategy was an excellent consensus-building tool for the supply management organization and other business units that participated. Organizations that prepare for supply chain risk and develop the agility to manage unplanned events will become stronger global business leaders. **ISM**

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