

SIX STRATEGIES FOR DECIDING WHICH CUSTOMERS TO SERVE WHEN DISRUPTION STRIKES

By Yossi Sheffi

Large-scale disruptions such as the COVID-19 pandemic cause huge supply/demand imbalances due to interruptions in supply or surges in demand. In an unstable environment, companies often have to prioritize which customers they serve.

Past disruptions reveal how companies on both ends of the supply chain have handled such challenges, both in terms of tactics they employed and considerations they used for their decisions.

Here are six strategies described in my new book [“The New \(Ab\)Normal: Reshaping Business and Supply Chain Strategy Beyond COVID-19.”](#) They illustrate the diverse approaches executives can use to determine who gets what when extreme supply/demand imbalances occur.

Allocate Scarce Supplies and Capacity

With allocation, a company directly restricts deliveries by not fulfilling every order as requested. Factors such as a company’s financial situation, customer relationships, fairness, reputation, strategy and even customer survival are a few of the conflicting considerations that can come into play in these situations.

These different factors reflect trade-offs between the company’s self-interest to remain financially viable and the customers’ interests, as well as between short-term results versus long-term outcomes.

Favor the Most Profitable Customers

A popular allocation criterion is to direct limited supplies to the highest-margin products and customers.

For example, General Motors scrambled to find scarce materials in 2011 after a trifecta of disasters—an earthquake, the resulting tsunami and the related nuclear meltdown—hit Japan and devastated factories there. In GM’s crisis room, “Project J” had supply chain professionals scouring the globe to find sufficient parts to keep all of the company’s car factories running.

Despite the frantic search, at one point, GM could not find enough airflow sensors for its trucks. The team decided to prioritize full-sized trucks over small trucks because the larger vehicles were both more profitable and had smaller retail inventories.

GM temporarily closed a Chevrolet plant in Shreveport, Louisiana, which made the small Colorado pickup truck. Not everything went as expected. Shortly before the plant closure, more parts were found. However, it was too late and it took another week for the plant to reopen.

Favor Strategic Customers

A simple product profit margin calculation ignores the long-term importance of a customer. This includes issues such as the customer's growth opportunities or ability to switch suppliers.

Some companies favor their biggest customers based on total revenues or forecasts of lifetime value. During several disruptions to microelectronics suppliers over the past 25 years, the largest PC makers, including HP, Dell and Apple, were high on many suppliers' priority lists.

Assure Supply

During the onset of the COVID-19 crisis, demand for consumer staples outstripped manufacturers' production capacities.

Consumers began eating at home more and stocked up for sheltering in place, which drastically increased sales above historical levels. Makers of nonperishable foods had to allocate their overtaxed production capacity across various SKUs.

Many chose to suspend production of low-volume SKUs to ensure greater total supplies of products and simplify their supply chains by focusing on fewer products and localized production. General Mills, for example, cut its Progresso soup line from 90 to 50 varieties and eliminated some flavors and package sizes of breakfast cereal.

Fairness to All Customers

Some companies insist on "fair" or uniform allocations of volume because of commercial, cultural or legal reasons.

With a uniform allocation policy, all products or customers get identical treatment, such as the same fraction of ordered volume or the same upper limit on the number of items (e.g., limit two cartons of eggs). After the 2011 Fukushima nuclear disaster, many Japanese companies gave every customer the same fraction of their orders. Likewise, Intel, as a large supplier in the PC industry, generally uses a similarly uniform allocation approach to avoid the appearance of favoritism.

Fair fractional allocation isn't easy when customers try to game the system by artificially inflating their orders. To combat this, some companies allocate product based on a portion of pre-disruption historical order volumes. However, in some cases, the disruption does affect actual demand, and some companies take this into account in their allocation algorithms.

Favor Vulnerable Customers

Allocation by customer vulnerability can be a consideration if the product is essential to the customer's survival (medical or financial).

Amazon, for example, prioritized essential products such as food and medical supplies in allocating its limited fulfillment and shipping capacity when the COVID-19-related increases in e-commerce outstripped the retailer's abilities to fulfill and ship orders.

Similarly, during the pandemic, some retailers catered to vulnerable customers, such as reserving the first opening hour for the elderly and other at-risk populations to provide favored access to freshly restocked shelves in a newly cleaned store.

Even if the supplier's preferred allocation method favors larger customers, it may be willing to divert small quantities of supplies to ensure the survival of a smaller enterprise customer. Verifone, a maker of credit card processing equipment, wasn't a large buyer of the electric motors made scarce by the same 2011 floods in Thailand mentioned above, but the company's absolute dependence on these motors led suppliers to fulfill its small orders.

Going Forward

Regardless of the weakness or strength of the company going into a disruption, a properly managed who-gets-what strategy offers a way to minimize the damage from business interruptions. In the end, well-deliberated decisions about tactics, scope and time horizon can help a company come out ahead.

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