

**A Supply Chain Model for the
South African Recording Industry**

by

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**A SUPPLY CHAIN MODEL FOR THE
SOUTH AFRICAN RECORDING INDUSTRY**

SUMMARISED TABLE OF CONTENTS:

DETAILED TABLE OF CONTENTS	iii
LIST OF TABLES	xi
LIST OF FIGURES	xi
ACKNOWLEDGEMENTS	xii
SYNOPSIS	xiii
CHAPTER 1 SUPPLY CHAIN MANAGEMENT - A BASIC OVERVIEW	1
CHAPTER 2 MAJOR PLAYERS OPERATING IN THE LOCAL RECORDING INDUSTRY	32
CHAPTER 3 MODEL A: THE CURRENT LOCAL SUPPLY CHAIN	59
CHAPTER 4 OUTSOURCING TO A THIRD PARTY	81
CHAPTER 5 RESEARCH METHODOLOGY	105
CHAPTER 6 RESULTS, CONCLUSIONS AND RECOMMENDATIONS: THE PROPOSED OUTSOURCED SUPPLY CHAIN (MODEL C)	125
ANNEXURES	182
REFERENCES	211

A SUPPLY CHAIN MODEL FOR THE SOUTH AFRICAN RECORDING INDUSTRY

DETAILED TABLE OF CONTENTS:

CHAPTER 1

SUPPLY CHAIN MANAGEMENT - A BASIC OVERVIEW

1.1	Introduction	2
1.1.1	Problem statement	2
1.1.2	Supply chain management	4
1.1.3	Objective of the research	5
1.2	Research methodology	6
1.2.1	The business research process	6
1.2.1.1	Research attributes	6
1.2.1.2	Research steps	8
1.3	Managing existing business paradigms	10
1.3.1	Discontinuous business change	10
1.3.2	Changing the mindset	10
1.3.3	The impact of change on logistics systems	13
1.3.4	Maintaining a competitive advantage	14
1.3.5	Complete transformation	16
1.4	Evaluating channel strategies	18
1.4.1	Logistics management	19
1.4.2	Forecasting	22
1.4.3	Static and strategic components	25
1.4.4	Benchmarking	26

1.5	Contents of the thesis	29
1.6	Summary	30

CHAPTER 2

MAJOR PLAYERS OPERATING IN THE LOCAL RECORDING INDUSTRY

2.1	Introduction	34
2.2	Record industry terminology	35
2.2.1	Music publishing	35
2.2.2	Copyright	35
2.2.3	Publishing revenues	35
2.3	South African governing bodies	37
2.4	The artist	38
2.4.1	The individual artist or band	38
2.4.2	The signed artist or band	38
2.4.3	Artists' governing bodies	39
2.5	The record company	40
2.5.1	Main functions	40
2.5.2	Types of record companies	41
2.5.2.1	The Majors	42
2.5.2.2	The Independents	47
2.5.3	Record company governing bodies	48

2.6	The trade	49
2.6.1	Wholesalers	50
2.6.2	Dealers	50
2.6.3	Retailers	50
2.6.4	Independent stores	51
2.7	The consumer	52
2.8	Summary	58

CHAPTER 3

MODEL A: THE CURRENT LOCAL SUPPLY CHAIN

3.1	Introduction	61
3.2	The manufacturing process	61
3.2.1	Just-In-Time manufacturing	61
3.2.1.1	Just-In-Time principles	62
3.2.1.2	Information technology	63
3.2.1.3	Customer service	63
3.2.2	Management Information Systems	64
3.2.3	Compact disc manufacturing	65
3.2.3.1	Principles of CD manufacturing	65
3.2.3.2	Compact Disc Technologies	67
3.2.3.3	Sonopress SA	67
3.3	Warehousing and distribution	68
3.3.1	Receiving	68
3.3.2	Picking	69
3.3.3	Physical distribution	69

3.4	Marketing	70
3.5	Selling	71
3.5.1	Sales executives	71
3.5.2	Music For Pleasure	71
3.6	Debt collection	73
3.7	Management of receivables	74
3.7.1	Ad Valorem duty	75
3.8	Piracy	76
3.8.1	Piracy definitions	77
3.8.2	The effects of piracy	78
3.8.3	The Counterfeit Goods Act	79
3.9	Summary	80

CHAPTER 4

OUTSOURCING TO A THIRD PARTY

4.1	Introduction	82
4.2	Adding value through outsourcing	83
4.2.1	Outsourcing methodology	83
4.2.2	Collaborating with strategic business partners	86
4.2.3	Third-party logistics	88
4.2.4	Outsourcing integration driven by management	91
4.2.4.1	Management capabilities	92
4.2.4.2	Key success factors	93

4.3	Integrated supply chain management	96
4.3.1	Collaborating the supply chain	96
4.3.1.1	Present channel inefficiencies	96
4.3.1.2	Possible success factors	97
4.3.2	Supply chain integration	99
4.4	Outsourcing pitfalls	100
4.5	Summary	104

CHAPTER 5

RESEARCH METHODOLOGY

5.1	Introduction	106
5.2	The business strategy framework	107
5.2.1	Competitive and corporate strategy	108
5.2.2	Strategic decisions	109
5.3	Properties of the research	110
5.3.1	Rational and empirical thinking	110
5.3.2	Different thinking styles	112
5.3.3	Hypotheses	114
5.3.3.1	The role of a hypothesis	114
5.3.3.2	The hypothesis statement	114
5.4	The research methodology	115
5.4.1	Identifying the topic to be researched	115
5.4.2	Exploration and judgement of the situation	116
5.4.3	Designing the research study	116
5.4.3.1	Information sources	117
5.4.3.2	Primary sources of knowledge	118

5.4.4	Sampling and data capturing	121
5.4.4.1	Major players	121
5.4.4.2	Measurement scales	121
5.4.5	Evaluation and interpretation of the researched information	123
5.4.6	Writing the thesis	123
5.5	Summary	124

CHAPTER 6

RESULTS, CONCLUSIONS AND RECOMMENDATIONS: THE PROPOSED OUTSOURCED SUPPLY CHAIN (MODEL C)

6.1	Introduction	127
6.2	Contracting the artist	130
6.3	Manufacturing	130
6.3.1	Procuring components from strategic partners	130
6.3.2	Lead times	132
6.3.3	Costs of holding inventory	133
6.3.4	Benefits of holding inventory	135
6.3.5	A re-ordering model	137
6.3.5.1	Determining the re-ordering criteria	137
6.3.5.2	Calculating the quantitative value	139
6.3.5.3	The re-ordering formula	140
6.4	Warehousing	142
6.4.1	Distribution Resource Planning	142
6.4.2	Quality control and protection of intellectual property	143
6.4.3	Pro-active warehouse management	143
6.4.4	Designing a functional warehouse	145

6.4.4.1 Preliminary planning steps	145
6.4.4.2 Physical lay-out	147
6.4.4.3 Vertical space	148
6.4.5 Outsourced warehousing	149
6.4.6 Geographic location	151
6.4.6.1 Factors influencing location	151
6.4.6.2 Factors influencing delivery lead-time	153
6.5 Marketing	155
6.5.1 The business plan	155
6.5.2 The four marketing questions	156
6.5.3 The marketing plan	157
6.6 Sales	160
6.6.1 Selling skills	160
6.6.2 Types of buyers	161
6.6.3 Sales management formula	164
6.7 Inventory management	166
6.7.1 The Management Information System	166
6.7.1.1 MIS functions	167
6.7.1.2 MIS development	168
6.7.1.3 MIS advantages	169
6.7.2 SAP supply chain management	171
6.7.3 Order processing	172
6.7.4 Invoicing	172
6.7.5 Shipment reporting	173
6.8 Physical distribution	173
6.8.1 Outsourced distribution	173
6.8.2 Emergency shipments	175
6.8.3 A competitive advantage	176

6.9	Debt collection	177
6.9.1	Management of receivables	177
6.10	Royalty payments	178
6.11	Summary	180
	ANNEXURES:	182
	Annexure A: RISA strategic objectives	183
	Annexure B: The current RISA membership list	186
	Annexure C: A monthly breakdown of South African local sales	190
	Annexure D: A breakdown of local and international sales	191
	Annexure E: <i>Sonopress SA</i> price list	192
	Annexure F: Outlines for a service level agreement	194
	Annexure G: The re-ordering model	197
	Annexure H: Sales reports	200
	Annexure I: Questionnaire to players in the South African recording industry	204
	Annexure J: The scope of SCOR processes	209
	REFERENCES	211

LIST OF TABLES:

Table 2.1	Total sales of all music titles (both local and international) in the South African market (rand value)	52
Table 2.2	Local sales in the South African music market (rand value)	54
Table 2.3	International sales in the South African music market (rand value)	56
Table 3.1	Breakdown of the unit selling price of an average music CD	74

LIST OF FIGURES:

Figure 1.1	A supply chain of the recording industry	3
Figure 1.2	Schematic diagram of the three models	5
Figure 1.3	The generic benchmarking process	27
Figure 2.1	BMG revenues	45
Figure 2.2	Graph of South African music sales	57
Figure 4.1	Approach to managing logistics	88
Figure 6.1	A schematic diagram of MODEL C	127
Figure 6.2	Lead times for a make-to-order company	130
Figure 6.3	Schematic re-ordering model	137
Figure 6.4	Relationship between warehouse and transport costs	151

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SYNOPSIS:

This study was undertaken with one main goal in mind: to develop an unique outsourced supply chain management or logistical business process, specifically researched and formulated to be applied in the South African Recording Industry.

In order to successfully achieve this goal, thorough research into the players, processes and procedures of this unique industry was necessary. This research was methodically gathered over many months, firstly by studying *secondary* sources which were consulted in order to gather as much knowledge and information on the topic as possible. However, more important to this study was the *primary* research that was undertaken into this industry. Major players representing all areas of the industry were selected and contacted, including individual artists, artists' governing bodies, various independent and international record companies, record company governing bodies, the music trade (consisting of wholesalers, dealers, retailers and independent stores) and lastly the consumer or end-user. These selected players were contacted and interviewed by means of personal interviews, telephone calls or electronic mails. Subjects completed the questionnaire that is attached in the Annexure at the end of the thesis (companies interviewed are listed in the research methodology of Chapter 5). The information gathered from the completed questionnaires is integrated throughout the entire thesis. The analysis of the current channel (MODEL A) led to the development of the hypothesis statement (MODEL B) and then to tested outsourced supply chain model (MODEL C).

When conducting the initial research into the current processes and procedures of the South African Recording Industry, it was found that most record companies are forced to perform most or all logistical processes in-house, mainly due to a lack of suitable alternatives. These procedures include amongst others: the manufacture of stock, warehousing and inventory management, selling, marketing, debt collection and the management of receivables - which implies both forward as well as backward integration. It was clear that these processes do not at all form part of a record company's core competencies, which are in essence simply the recording and

publishing of music. Concentrating so much of their time and resources on managing these logistical processes, cause record companies in the South African industry to perform at below-optimum levels and offer an inferior service to the market and their clients in general.

In the hypothesis statement in MODEL B, a process was researched whereby all non-core logistical or supply chain processes are outsourced to one logistical or supply chain management business partner.

The results of this investigation led to the development of MODEL C, in which the supply chain management company does then, on behalf of its record company client, procure all stock and store it in its own secure warehouses and perform all stock control and inventory management processes. The supply chain management company is also responsible for selling the stock into the trade and for all aspects of the distribution and physical delivery thereof. This thus leaves the record company free to concentrate on its own core competencies.

This thesis firstly explores supply chain management in general by discussing a basic overview on the topic. Next the various *players* in the South African Record Industry are researched, where after the current supply chain *processes* are analysed and documented (MODEL A). The methodology, advantages and disadvantages of outsourcing business processes to a third party business partner are researched and evaluated in Chapter 4. The second last chapter contains the complete research methodology of the thesis (MODEL B), where after conclusions are reached and recommendations are made in the final chapter (MODEL C).

CHAPTER 1

SUPPLY CHAIN MANAGEMENT - A BASIC OVERVIEW

1.1	Introduction	2
1.1.1	Problem statement	2
1.1.2	Supply chain management	4
1.1.3	Objective of the research	5
1.2	Research methodology	6
1.2.1	The business research process	6
1.2.1.1	Research attributes	6
1.2.1.2	Research steps	8
1.3	Managing existing business paradigms	10
1.3.1	Discontinuous business change	10
1.3.2	Changing the mindset	10
1.3.3	The impact of change on logistics systems	13
1.3.4	Maintaining a competitive advantage	14
1.3.5	Complete transformation	16
1.4	Evaluating channel strategies	18
1.4.1	Logistics management	19
1.4.2	Forecasting	22
1.4.3	Static and strategic components	25
1.4.4	Benchmarking	26
1.5	Contents of the thesis	29
1.6	Summary	31

1 SUPPLY CHAIN MANAGEMENT – A BASIC OVERVIEW

1.1 Introduction

The way in which companies have conducted, managed, controlled and integrated their business operations have experienced dramatic changes during the last couple of years – this is especially true in the worldwide recording and music industries. Rapid advances in technology and increasing regulatory freedom have changed the rules of operation and competition. Businesses are now competing globally and traditional barriers between industries are breaking down. To cope with these and other changes and achieve superior performance, business leaders are moving towards new business paradigms that allow their companies to work more closely together with their traditional and new business partners (which include all clients and suppliers up and down the supply chain), in order to adapt to the rapidly changing marketplace.

As discussed in the fourth chapter under point 4.2, it is proposed by the mentioned authors that this new collaboration can be successfully achieved by outsourcing all non-core business activities to a third party business partner, which in turn will lead to an improved integration through supply chain management. As companies focus on their core activities and outsource the rest, their success increasingly depends on their ability to control what happens in the value chain outside their own boundaries (Magretta 2000: 29 - 59). Supply chain leaders are thus reconsidering the linkages, not only between functions within their own companies, but also with other organisations up and down their supply chain. The main advantages of this outsourcing process, is that the company is then free to focus on its core competency, which in this case is simply the recording and publishing of music.

1.1.1 Problem statement

The South African recording industry provides a unique and compelling case for creating value through outsourcing - and ultimately through the total integration of supply. The local industry's dramatic history of growth, its sheer pace, the magnitude of

change and increasingly complex and global supply chains have created huge challenges for all participants. Traditional channel structures and behaviours in the industry’s supply chains have not kept pace with these changes. In the markets of the future, comprehensive management which collaborate the supply chain as a whole is needed to fulfil the new demands set by players and consumers alike.

The hypothesis statement of this thesis is in part derived from the problem statement. This hypothesis statement is discussed in the research methodology in Chapter 5 under point 5.3.3 and is stated as follows:

“Record Companies in the South African Recording Industry should outsource all their non-core business activities to one strategic business partner.”

It is clear to see how this statement is derived from the problem statement of this thesis, as described here in point 1.1.1. This statement, as well as the opportunities and problems it may present, is the core around which this thesis centres.

Figure 1.1 A supply chain of the recording industry

Backward Integration	Record Company	Forward Integration
<p><i>Additional functions:</i></p> <ul style="list-style-type: none"> • Manufacturing • Warehousing • Inventory management • Stock insurance 	<p><i>Traditional functions:</i></p> <ul style="list-style-type: none"> • Contract artists • Record master CD's • Publish music 	<p><i>Additional functions:</i></p> <ul style="list-style-type: none"> • Marketing and promotions • Sales • Order entry • Picking and packing • Physical distribution • Debt collection

Source: Own research.

In addition to the problems mentioned above, another problem addressed in this thesis centres around the extensive backward and forward integration that has been forced upon the traditional record company (also refer to the discussion on the current logistical processes of MODEL A in Chapter 3). Figure 1.1 on the previous page depicts the functions that a record company should traditionally be responsible for (its core competence). It then also shows all the other functions that record companies around the world now generally perform in-house in order for its product to reach the market.

1.1.2 Supply chain management

A growing number of businesses in South Africa and throughout the world are using the term ‘supply chain’ to describe a process whereby both internal and external units are forged together to deliver low-cost and high-value performance to the client or consumer. As long as a decade ago (Robeson and Copacino 1994: 11 – 12) the ‘supply chain concept’ was compared and related to the ‘cycle-time concept’ – this means that organisations that develop a continuous-flow inventory system frequently do so with a limited number of primary accounts, often using third-party logistics partners. Also refer to Chapter 6, point 6.3.2, for a comprehensive discussion on lead times and other aspects relating to the time-to-market timeline.

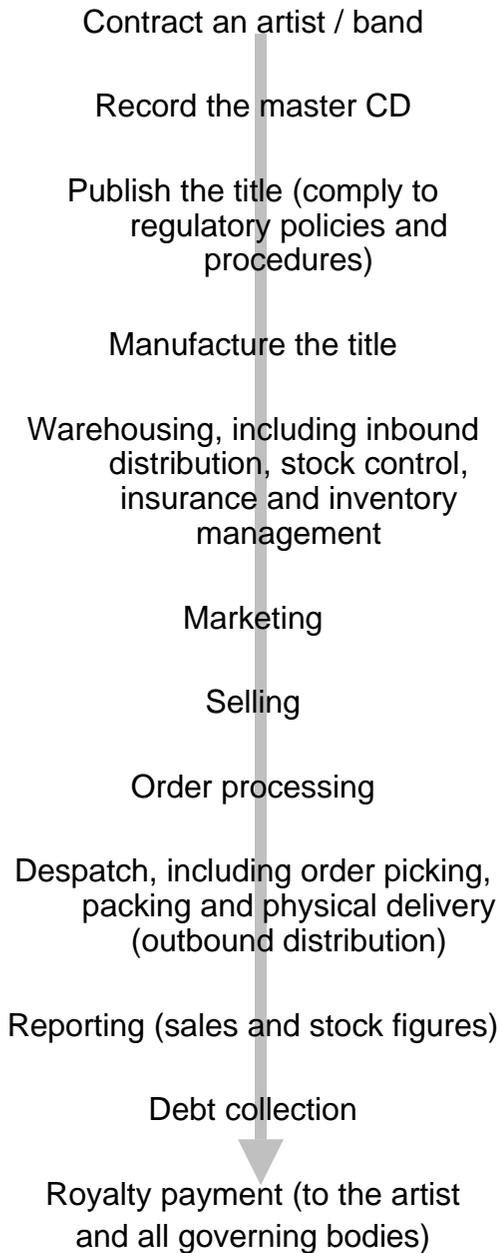
Implementation of a ‘cycle-time-to-market strategy’ may then result in the focused implementation of a supply chain management (SCM) strategy. Businesses will need to design, develop and maintain a set of relationships both within and outside its organisation (*i.e.* between the company and its vendors, suppliers, third parties and customers), capable of executing the overall corporate strategy. Robeson *et al* (1994: 12) further believed that the ability to manage *between* functions would become as important as the ability to manage *within* a function. By examining the hypothesis statement of MODEL B, this study will prove this statement correct (refer to the functions of the supply chain management company discussed in MODEL C in Chapter 6).

1.1.3 Objective of the research

Figure 1.2 Schematic diagram of the three models

Source: Own research

MODEL A



MODEL B

THE HYPOTHESIS STATEMENT
“Record Companies in the South African Recording Industry should outsource all their non-core business activities to one strategic business partner.”

MODEL C

Record Company’s responsibilities:

- Contract an artist / band
- Record the master CD
- Publish the title
- Marketing
- Royalty payment

Supply Chain Management Company’s responsibilities:

- Manufacture the title
- Warehousing
- Selling
- Order processing
- Despatch
- Reporting
- Debt collection

The objective of this research is three-fold:

- (a) Examine the current local recording industry, its players (Chapter 2) and its processes (Chapter 3). This current supply chain is referred to as MODEL A. The way in which record companies have been forced to integrate backward and forward into other industries, is also researched and evaluated.
- (b) Research and evaluate a new business principle whereby all non-core business activities are outsourced to a third party supply chain management partner that can manage and perform all the record company's non-core business activities (discussed as the hypothesis in Chapters 5). This hypothetical supply chain is referred to as MODEL B
- (c) Document the outsourced model where non-core business activities are outsourced to the third party supply chain management partner. This tested model is referred to as MODEL C.

1.2 Research methodology

1.2.1 The business research process

1.2.1.1 Research attributes

Business and management research need to provide findings that advance knowledge and understanding, it also needs to address business issues and provide a process for solving managerial problems (Saunders, Lewis and Thornhill 2000: 2 – 4). During the research of this thesis, the six attributes of a proper business research process were followed closely:

- (a) Define the objective of the research
The objective of the research was clearly described in the first chapter under point 1.1.3 above. The hypothesis statement is described in the research

methodology in Chapter 5. The objective of this thesis encompasses research into the current local recording industry, its players, its channel processes and its backward and forward integration (MODEL A). The research was then broadened to explore the outsourcing of some or all non-core business activities to strategic third party supply chain management partners (the hypothetical MODEL B which lead to the tested MODEL C).

(b) Define the research procedures

The research procedures that were followed are defined and explained under the research methodology in the fifth chapter.

(c) Planning procedures

Thorough planning was of primary importance throughout the entire research process. The planning procedures were centred around the defined problem statement, the research objectives and the hypothesis statement (MODEL B).

(d) Review research imperfections

Any faults, shortcomings or imperfections of the research process were predicted and estimated. The impact that such shortcomings have on the final conclusions are noted and explained.

(e) Data analysis

All data were analysed in order to determine its relevance, validity and importance to this study. Data were gathered by circulating questionnaires to record companies, their clients and suppliers as well as to supply chain management companies – details of the respondents are discussed in Chapter 5 under point 5.4.3.2. The questionnaire is attached as Annexure I at the end of the thesis. Personal interviews were conducted with various players in the local recording industry (refer to Chapter 5 point 5.4.3). In conjunction to this primary information, literature sources (text books, academic journals and magazines, scientific publications, websites and others) were studied in order to obtain

relevant secondary information (refer to the list of References at the end of the thesis).

(f) Conclusions and recommendations

Conclusions and recommendations are limited to the data and information that were gathered and which were justified by the research parameters. These conclusions and recommendations are summarised and explained in the last chapter, where MODEL C documents the outsourced supply chain model.

1.2.1.2 Research steps

Following a set of systematic steps is vitally important to the planning, order and execution of any scientific research process. The research in this study was executed by following seven basic steps, which are listed below in chronological order:

(a) Determining research objectives and the scope of the study

The topic to be researched was identified early in the research, and was registered as: A Supply Chain Model for the South African Recording Industry.

(b) Current situation exploration

Exploration and judgement of the current South African situation, its players, markets and industries are explored and documented in Chapters 2 and 3. Where the South African market was lacking in sufficient examples, the international scene was also explored and judged in terms of its validity to be implemented in the current South African situation. Primary information (questionnaires, personal interviews, telephone conversations and electronic mails) as well as secondary information (textbooks, publications, scientific articles and others) were utilised throughout the situation exploration phase. These are discussed in more detail under the research methodology and the sources of knowledge in Chapter 5.

(c) The study design

The design of the research study was drafted in accordance with the prescribed methodology of a proper research proposal that were explained in point 1.2.1.1 above.

(d) Sampling and data capturing

Sampling and data capturing of all information gathered from research as well as from interviews with targeted players in the recording industry are utilised. Employees of record companies, music dealers, compact disc manufacturers and supply chain management (SCM) companies were contacted and interviewed through personal interviews, telephone conversations and electronic mails (refer to the details of the respondents in Chapter 5 under point 5.4.3).

(e) Information evaluation

All researched data were scrutinised and reduced to a manageable quantity, where after it was used to develop summaries, conclusions and ultimately the new MODEL C in the last chapter.

(f) Information analysis

The gathered data and information were analysed, assigned with qualitative and quantitative values and then interpreted and used as sources of knowledge in the writing of the thesis.

(g) Writing of the thesis

The thesis was written in a systematic and planned way using different thinking styles and sources of knowledge, while utilising all sources of information available. These are once again explained in the research methodology in Chapter 5.

.

1.3 Managing existing business paradigms

1.3.1 Discontinuous business change

The worldwide recording industry has undergone some revolutionary changes over the last couple of decades (refer to the technological input of *Sony Music Entertainment* described in Chapter 2). Businesses now find themselves in a mode of continuous change and these changes (also referred to as discontinuous business changes) are abrupt and sudden, leapfrogging ahead of predefined expectations, driven by new discoveries and the application of innovations, new technologies and new trends and music genres. Behrmann (2000: 1 – 2) defines discontinuous change as almost the opposite of change as we know it – being a ‘gradual transition based on an evolution from past events’. Understanding whether this unevenly distributed revolution has arrived in an industry and how much dislocation it will create, is crucial to business success.

1.3.2 Changing the mindset

Businesses are evolving and changing at a rapid pace, and towards the end of the previous century leading businessmen and –women have warned that businesses who want to keep up with the changing pace, or better still be a step ahead of the competition, will have to look at new ways to better their current business operations (Hatton 1996: 16 – 17). Only those individuals and companies who can proactively adapt to these fluctuations and discontinuous changes will survive. The Group CEO (Chief Executive Officer) of a major international information technology company (Ling 1999: 1 - 2), believes that everybody has biases and perceptions about their own abilities, opportunities and futures as well as those of their companies. Traditionally, local companies and especially local record companies, have preferred to perform all logistical functions in-house. There is an unfounded desire to keep all business functions close to the business itself so that it can be tightly and internally managed. Breaking out of these beliefs and being open and receptive to change, both personally and organisationally (for example, letting go of some of the control and outsourcing

some business processes to a third party), lies within the person and the company's inherent mindset (Jeannot 2000: 3 – 4).

The role that is played by these established and fixed mindsets (also referred to as paradigms or thought patterns) in a specific company, industry or business environment must not be underestimated. Although they may have some advantages, they more often than not have a negative, restraining effect on change and evolution. Primary research conducted into specific paradigm characteristics (research performed by means of personal interviews, telephone calls, electronic mails and questionnaires as listed under point 5.4.3.2) were in accordance with the findings of De Villiers (1996: 27 – 30). The following four main characteristics were identified:

(a) A way of thinking

A mindset or paradigm invariably leads to a way of thinking, a structure of reference or boundaries within which a person handles or evaluates incoming information - this concept was first discovered and described by Thomas Kuhn in 1970. There is no such thing as a completely objective person. Paradigms colour the perceptions, decisions and actions of all people, either negatively or positively influencing the ways in which they conduct business and make business decisions.

(b) A fixed mindset

Especially in a business that is well positioned, functioning profitably and performing close to optimum levels, paradigms will be set strongly and followed meticulously. Any new ideas, innovations or technologies (such as outsourcing current profitable business operations or processes) will therefore not be accepted easily.

(c) An information interpreter

A paradigm performs the same function as a sift, selecting which of the received information is to be interpreted as well as in which way. If a conflict exists between the information received and the person or the business's paradigm, the

information will in most cases be ignored. The mind is very effective in finding and sifting the facts that will support a particular mindset or point of view. This means that a person's mind or a business as a whole will focus on the data that it needs to support its own point of view. In all people there is an inherent resistance to change, which plays a huge part in the way data are digested or processed. It is therefore imperative to challenge the mind to find some mind-opening practices and eliminate those practices that limit breakthrough thinking.

(d) An industry leader

It is important to note that when a set paradigm is changed or a paradigm-shift has taken place within a leading business enterprise, it will influence all other players in the industry. When a new, improved technology or innovation is developed and implemented by one company, all other players competing in the same industry will have to follow suit. A good example was the development and introduction of the 33 1/3 rpm (revolutions per minute) long play record into the recording industry in 1948, as well as the introduction of the CD (compact disc) in 1982 (www.sonymusic.com). A company that may have had a big market share before those technological innovations were adopted by the market, would quickly find itself with diminishing sales and growth if it did not also adopt the new innovations.

Deeply set within the collective mindset of a business are all the experience, learning and beliefs of the past. Whereas it is imperative to stimulate learning in the organisation and to capture and hold the essential intellectual property that is the business's asset, it is just as important to *unlearn* what is no longer relevant and thus stifling the ability of the business to really innovate and become a market leader. Unfortunately, bringing about mindset change is hugely difficult. Since it is a fight against a basic and ingrained behaviour or way of thinking, enormous energy will be spent in trying to prove that the person or the business has been right all along and that there is really no reason to change the mindset and adapt any new innovations or business processes (like outsourcing a part of the supply chain).

USB-ED (University of Stellenbosch Executive Development) is a private executive company within the University of Stellenbosch Business School (www.usb-ed.com). During 2003, the company presented training courses consisting of presentations, case studies, exercises and interactive group work, at various venues around the country. These courses introduced participants to the structural and systematic impact of change, so that after completing the course, the learners should be able to:

- Know what change they are dealing with
- Understand which variables, issues or factors have the biggest impact
- Clarify what they really want to accomplish
- Learn how to stay on the designated or chosen course
- Understand the link between structures, change and results

The presenters propose that anybody who is involved in an imminent, current or proposed business change initiative should attend the course. These and other courses should assist business managers to deal with their paradigms and rationally review and implement the necessary business changes.

1.3.3 The impact of change on logistics systems

Change can either be viewed as a thorny management issue, or as an important competitive advantage. For logistics practitioners, change comes in many forms, for example faster order cycle times, increasingly differentiated products and services and ever more sophisticated technologies to help manage all of this complexity. One consequence of these changes is the need for more dynamic and responsive logistics systems that can readily adapt and respond to the changing needs and requirements. This study will aim to prove that the key to mastering change as a competitive weapon has two equally important facets: firstly the development of internal company capabilities and competencies necessary to be truly productive, profitable and flexible, and secondly to develop linkages and partnerships in the supply chain in order to reap the optimum benefits of the logistics or supply chain management process.

A logistics system can be termed a competitive advantage only to the extent that it provides customers with products and services that they want or need, when they want or need them. Once customer services strategies are identified, marketing and distribution channels must be designed to perform to the required standards. Analytical tools can be used to optimally allocate and deploy financial and human resources to achieve desired levels of service in a logistics network. Preparing the business for change and doing things differently, may be the most important step in successfully implementing new logistical strategies.

1.3.4 Maintaining a competitive advantage

After breaking away from the limiting paradigms of the past, the reborn business must aim at achieving and maintaining a competitive advantage over its competitors. Every academic, author, entrepreneur and businessman or –woman hold a different view on the elements required to manage and maintain a winning company. Through research it was determined that the following four basic elements adequately sum up the aspects that need to be considered and / or achieved in order to maintain a sustainable competitive advantage in the discontinuously changing record industry:

(a) Knowledge

Only knowing is not sufficient anymore. Knowledge, which can be defined as ‘having the capacity for informed action’, is needed to stay ahead of the pack (Szylo 2000: 1 – 2). Knowledge is an extremely powerful business tool - it can even change set paradigms in a successful business. However, knowledge is useless if it is not also managed properly. The following three steps list how knowledge must be obtained and then managed:

- Firstly, businesses need to obtain the necessary knowledge, whether it is through primary or secondary resources or just by learning through doing (*i.e.* learning by experience)

- Secondly, infrastructures then need to be created which will ensure that the knowledge obtained is retained and shared with the relevant people at the relevant time
- Lastly and probably most important, the record company's management team needs to *act* on its obtained knowledge. It needs to, at all times, keep track of emerging trends, new technologies, innovations and all other possible opportunities and threats in the market. The key to achieving success is to be pro-active rather than reactive. In order to maintain a winning company, the relevant knowledge gained must move employees and management alike into motion and lead them to deliberate action. This ties in directly with the statements made by Ling (discussed in point 1.3.2 above) on the importance of not just knowing, but taking action by changing the ways in which things have always been done (*i.e.* changing the business paradigms and mindset)

(b) Connectivity

The more people or businesses work together in a network or in a supply chain, the higher the value of that network becomes. Internal connectivity as well as connectivity to the outside world must not be rated as purely sufficient, but must be seen to offer added value. In order to successfully manage either knowledge, change, transformation or any other organisational issue, there needs to be connectivity in the channel. Both connectivity ('point b' above) as well as speed (discussed in 'point c' below) are needed to extract value from the above-mentioned knowledge (in 'point a' above).

(c) Speed

Speed to market is vital. Getting the latest music release sold and delivered into the trade and onto shop shelves before the competition will ensure at least an initial market dominance. Just as important is speed of communication to customers and suppliers (*i.e.* successful marketing as is discussed in Chapters 3 and 6). Most businesses operate in real time and need the correct and relevant information available at the click of a button. This is one of the main advantages

that outsourcing selective business processes to a third party can add to any business' operations, since these third party operators will manage stock, control inventory and produce daily stock and sales reports as requires by their client companies.

(d) Effectiveness

Actually doing different things instead of just doing the same things differently, is another characteristic that defines success. Record companies need to differentiate themselves from their competitors by the way they do things, such as their ways of internal and external communication, their network connectivity, marketing, quick lead-times and superior service levels.

1.3.5 Complete transformation

Very often, a business struggles to adapt to changes in the market by simply disregarding or adapting its own set of paradigms. More often than not a complete business transformation is necessary to stay ahead of new technologies, innovations and trends. This transformation may include changing the structure, people, skills, operations, technology, procedures, philosophy or culture of the business and / or its employees. In order for this re-creation or re-generation to work, a business needs a strong strategic imperative, a plan and a capable multi-disciplinary team committed to executing change. Of primary importance is the belief of all participants that this transformation will ultimately lead to a better business model and a better future for the company as a whole. Passion, vision and insight are necessary to grasp the possibilities of where the company is heading. The point of departure is openness and trust and moving forward will require communication and motivation.

Various authors view transformation management as one of the critical success factors of the new millennium (Jeannet 2000: 199 – 214; Szylo 2000: 1). The challenges in managing change go far beyond the requirements of developing and managing traditional businesses. In many ways it is also much more difficult than starting something from scratch. As discussed above, existing paradigms and their set structures

are resistant to change. The challenge lies in maintaining both the performances of the existing company structure while at the same time moving towards new and improved policies and procedures.

Transformation is not a single event but a series of steps in a process. In conceptualising the process of transformation it is essential that the complexity and sensitivity of the challenge be acknowledged. There exists some useful building blocks that can be used in constructing the transformation process. The programme will require strategy, marketing, technology and many other company resources. Ling (1999: 2 – 4) has identified the following four building blocks in establishing a successful transformation process (also includes ideas based on the Wheelwright-Clarke model):

(a) Research phase

The first building block of the transformation process is the very important research stage. It goes without saying that not everything that needs to be known is known at the outset of a project. Information can be gained by primary research or by consulting secondary sources. As new ideas and alternatives are considered, they must be discussed completely and challenged entirely by the appointed research team.

(b) Pilot phase

The next building block is piloting the most likely of the ideas, which allows the team researching the possible transformation alternatives to assess some of the ideas in a more practical environment. This will add more light to the way and direction in which the transformation process is moving.

(c) Establishment phase

In the establishment phase the ideas that have survived the piloting phase are applied more broadly in order to create something even more practical to work from. Although this can already be seen as the start of a definite design, dynamics of the research team and the record company itself will still affect the decision to outsource or not, as well as the transformation thereof.

(d) Implementation phase

Finally, the last building block is laid by implementing the best practice in a steady state. In order for the outcome to be successful, continuous assessment, communication, interaction, learning and feedback throughout the previous stages, and in fact throughout the entire newly established supply chain, are vital.

Transformation is implemented and managed in order to change paradigms that may no longer be relevant in the present-day recording industry – which in turn has been proven to be undergoing rapid, involuntary and discontinuous changes up and down its supply chain. Transformation management often means changing a complex system that will result in an integral reaction where one point of change will have an effect throughout the whole system or the whole chain. Transition through successful transformation management should be viewed as a core competence in any organisation, since being the first to implement the process of transition into the future, will be awarded with a competitive advantage, at least until the rest of the players in the market catch-up.

1.4 Evaluating channel strategies

After a record company's paradigms have been evaluated and changed for the better, the company may have reached the decision that, in order to keep up with the discontinuous changes in the recording industry, it needs to change its existing business strategy. One available and very viable alternative is to outsource some of its business activities to strategic logistics partners. This will mean that company management will not only be responsible for managing their own business, but also for the chains and links with their outsource partners. This in turn will call for a channel strategy that will optimise all operations between the company itself, its clients and its suppliers in the channel. Companies must be equipped to build into each and every one of these logistical channel decisions, an assessment of whether the transaction supports or erodes the business's strategic objectives, which at the end of the day is to sell as many music records (*i.e.* CD's, tapes, DVD's, video's and others) as possible.

Throughout the research and writing of this thesis, the principles contained in the Supply Chain Operations Reference model (SCOR) were kept in mind. This model was developed by the Supply Chain Council (www.supply-chain.org), which is an international and independent not-for-profit corporation. Refer to Annexure J at the end of the thesis for the scope of the SCOR processes.

1.4.1 Logistics management

The evolution of the supply chain management or logistics concept has clearly been documented in many logistics books and articles published over the last five decades. A careful review of this literature provides a foundation for tracing the evolution of the supply chain management or logistics organisation and its processes and procedures.

According to Robeson and Copacino (1994: 13 – 34) the evolution of business logistics can be divided into the following three eras or phases:

(a) Functional management (1960 to 1970)

During the 1960's and 1970's, many organisations made a gradual transition from the fragmentary management of individual processes like purchasing, warehousing and distribution to the integrated management of related functions under the two common headings of materials management and physical distribution:

- Materials management included functions like purchasing, raw materials, work-in-progress, inventory control, inbound transportation, surplus material and production scheduling
- Physical distribution included functions such as freight, warehousing, materials handling, protective packaging, order processing, demand forecasting, inventory control and customer service

The three main forces influencing the logistics company in the 1960's and 1970's are discussed on the following page:

1. The high costs of performing distribution functions, which accounted for nearly 50% of the cost of many consumer products (La Londe and Zinszer 1976: 1).
2. The introduction and application of computers, which lead to a tremendous increase in the number and sophistication of tools available to the company manager.
3. Pressures to improve customer service and productivity, while decreasing the costs of the distribution operation.

(b) Internal integration (1980 to 1990)

By the 1980's, logistics organisations had experienced a decided shift in the positioning of their distribution and materials management functions. Integrated logistics was now seen as 'the total range of activities concerned with the movement of materials, including information and control systems; logistics constituted a strand running through all the traditional functional responsibilities – from raw materials procurement to product delivery' (Sharman 1984: 72). Supply chain management now encompassed the traditional responsibilities for both physical distribution as well as materials management.

The main forces shaping the logistics business in the 1980's were:

1. The introduction of third-party logistics companies (refer to the detailed discussion on outsourced third-party logistics in Chapter 4).
2. Improved communication and information technology (refer to the processes of supply chain management and the use of information technology discussed in Chapter 3 and 6).
3. The introduction of Distribution Resource Planning (DRP) as a popular inventory planning and deployment tool based on exploiting the

information and connectivity of integrated systems (discussed in more detail under the warehousing function in Chapter 6).

4. The Just-In-Time (JIT) concept that strives for overall excellence and has the aim of eliminating all waste while consistently improving quality (refer to the comprehensive discussion on JIT in Chapter 3).
5. Lastly, customer service ranked as one of the major forces influencing the growth and development of corporate logistics functions.

(c) External integration (1990 onwards)

The organisational structure that emerged for logistics and supply chain management activities in the 1990's followed a pattern of external integration. Supply chain management now extended the concept of functional integration (as discussed in 'point a' above) beyond the organisation to all organisations in the supply chain (Ellram and Cooper 1990: 1). The focus had shifted to viewing the organisation within the context of an overall chain of value-creating activities of which the organisation itself is only one part.

The main characteristics of the last decade of the previous century were:

1. An understanding of costs and the sources for differentiation. Supply chain members began to understand each other's costs and began to work together to more efficiently improve profit margins.
2. Integration across the supply chain reduced an individual company's risks by spreading its investments, leveraging information against inventory and pooling expertise.
3. The supply chain began to gain leverage by utilising each other's resources (*e.g.* new markets, process innovations, production information and others).

4. Internationalisation and globalisation generated new markets and pooled skilled labour.
5. An explosive development of information and communications technology had a pervasive effect on all aspects of business – information technology is discussed in more detail in Chapter 6.

The integration of the logistics process during the past four decades has transformed the logistics organisation into a sophisticated management organisation. The transformation resulted from a variety of factors mentioned above, but the principal driver has continually evolved around the notion of achieving a competitive advantage through logistics and supply chain management. The competitive advantage could take many forms, from lower costs and increased profitability to improved and differentiated customer service.

However, before any company can formulate its optimal channel management strategy, a calculated and deliberate overview of all the activities involved is needed. In an ideal world, customer demand would be smooth and growing. Demand would be perfectly predictable and therefore enable perfect planning of the supply chain. Unfortunately, this is seldom the case. Buys (2000a: 1 – 4) therefore states that demand planning or forecasting should be the first activity to receive attention as part of an optimal channel strategy.

1.4.2 Forecasting

Companies today are faced with consumers who expect to buy the latest and newest products on the market – these products must use the latest technology, be completely reliable and of a high-quality. Thus, getting the right product to the right place at the right time and at the right price, is becoming more than just a competitive advantage – it is becoming a necessity for survival. This is one of the main reasons why putting together the detailed components of demand planning or forecasting is emerging as a critical factor for business success. The product of the demand plan or forecast is the

anticipated sales for whatever planning period is applicable to the products or the business as a whole. Hughes, Ralf and Michels (1999: 102) state that the essence of the quick response forecasting approach is no longer about selling what you have recorded or manufactured, but about recording or manufacturing what you will eventually be able to sell.

One of the keys to excellence in demand forecasting is *collaboration* (Gattorna 1999: 131 - 133). The greater the amount of information that can be incorporated into a forecast, the more accurate it is likely to be. Gattorna explains that when different business functions each develop their own forecasts, they typically do so with different assumptions about the factors that will ultimately affect demand. In a well-functioning process, operations can have a far-reaching impact on the accuracy of the demand forecast. Based on feedback from the operations department, the marketing team may decide to cancel a promotion scheduled for a music album currently in short supply and rather re-direct the associated spending to titles with higher inventory levels. Similarly, the sales force may be re-directed in terms of which titles to aggressively sell or push into the market. It is clear to see how the inclusion of operations in the planning process increases in importance as a business becomes more constrained by supply. While operations can thus provide critical information on product supply, the primary sources of information relating to the actions that need to be taken to stimulate demand, will always be primarily driven by the sales and marketing team of a company.

Forecasting has been in use for many years and can be a very effective business tool (documented by Granger in 1980: 153 – 165). Through personal interviews conducted by the author, it was discovered that most record companies do in fact use forecasts in their manufacturing decisions. There are usually ‘producers’ (the employees actually researching, performing and documenting the physical forecasts) and the ‘users’ (usually the top management team) who incorporate the forecasts in their decision-making processes. Its implementation as part of the business’s channel strategy will offer a number of significant benefits, such as:

(a) Reduced risk

Reduced risk accompanied by an increase in certainty of demand can be achieved. The more information gathered for the forecast (be it from the sales and marketing team, or via the operations department), the lower the risk of receiving unprepared-for orders becomes.

(b) Calculation of danger stock levels

By planning ahead and being aware of future orders, a company will be able to calculate its needed stock levels. A reduction in inventory levels, which in turn holds significant capital benefits, will be achieved by implementing the information gained through the forecast.

(c) Production and human resource planning

Fewer staff will be needed to cover demand peaks, for example during the very busy Christmas holiday shopping season when record companies usually achieve their highest sales figures (refer to the sales graphs in Annexures C and D at the end of the thesis). If the forecasting system is accurate, these increased levels of demand can be anticipated and adequately planned for. The high amounts of money, which usually needs to be spent on paying over-time salaries, can then be drastically reduced.

(d) Better demand planning

A definite improvement in the visibility of the customer or the end-user's demand can be obtained. By collaborating the research and experience of all divisions (operations, sales and marketing), a better idea can be formed of what the needs of customers will be like in the future. This will lead to better planning through the use of an improved forecasting system.

(e) Improved customer service

Improved customer service will be a direct result of proper forecasting and planning, since the right product will be available at the right time and at the right place.

Even with a proper forecasting system in place, a business on its own may still at some points in time, not be able to cope with situations of exceptionally high demand. It is here where businesses that cannot afford to ever be in an out-of-stock situation (or not have sufficient goods on hand to satisfy a sudden increase in demand), may well be advised to outsource some of their non-core business processes or operations such as procurement, warehousing, inventory management, sales or distribution to a supply chain partner.

1.4.3 Static and strategic components

By adding static and strategic policy components to the forecast, it is then possible to build a model of how inventory should flow during a given period. The task at hand is, however, how to put this theory into practice. The *static* components are relatively simple to determine. They can be assigned quantitative values by answering general questions such as:

- What is the manufacturing and delivery lead-time from the supplier?
- How often is the order repeated (order frequency)?
- How much is ordered at a time (order quantity)?

Any decent Enterprise Resource Planning (ERP) system will be able to incorporate the above-mentioned *static* components into a report. Hossain, Patrick and Rashid (2002: 2 – 3) identifies ERP as software systems for business management, encompassing modules supporting functional areas such as planning, manufacturing, sales, marketing, distribution, accounting, financials, human management, project management, inventory management, transportation and e-business.

It is, however, not these static components that are difficult to identify, quantify and report on, but the *strategic* policy elements influencing channel decisions that need a lot more thought and proper planning.

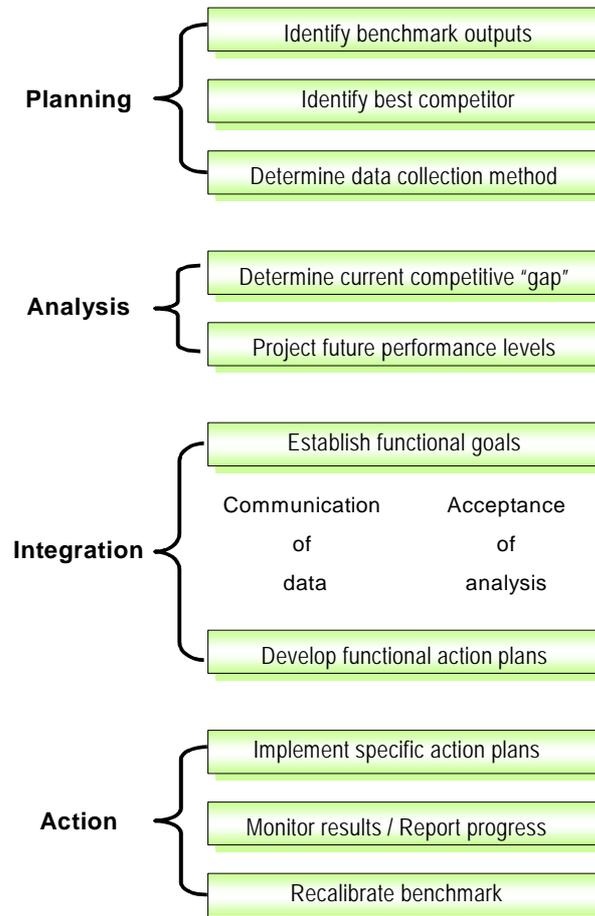
Forecasts, lead times, order quantities and other variables will unavoidably and inconsistently change, but it is here where the concept and advantages of *safety stocks* come into play. Unfortunately, even if it is possible to provide intelligent answers to the static questions mentioned above, no ERP system will be able to translate those answers into the optimal safety stock level. According to Buys (2000b: 1 – 4), in order to optimise the supply channel, it is necessary to ensure that the least amount of inventory is held - that means just enough to maintain the targeted level of necessary inventory. It is perceived that the better supply chain management solutions will use neural programming techniques to combine the static and strategic components and then calculate the correct safety stock level at which the business must make its replenishment decisions. In Chapter 6 a standard re-ordering system is researched and developed for the local South African recording industry (incorporating variables such as the current stock holding, the weekly orders received and the status of the title and the artist in the market).

1.4.4 Benchmarking

In the past it was usually deemed sufficient simply to measure internal company performance. Today, most companies use various tools such as service level agreements (SLA's) and pricing models to ensure that they receive the solutions they require from their strategic partners in the supply chain. A company can however never be sure that these measurement tools are in fact in line with industry's best practice. The intense level of competitive activity encountered, especially in recording industries around the world, has led to a new emphasis on measuring performance not just in absolute terms, but rather in terms relative to the competition. This is where the tool of benchmarking comes into play. Human (2000: 1 - 2) lists various academic definitions for the benchmarking process. Karlof, Lundgren and Froment (2001: 27 – 33) explain that the word benchmarking simply means a fixed point. Management science uses it as a metaphor for the point to aim at or standard to achieve in some form of performance, usually expressed in terms of efficiency, customer value or productivity. Competitive benchmarking can also be defined as the continuous measurement of the business's products, processes and practices against the standards of best competitors and other

businesses which are recognised as leaders in the particular industry. Figure 1.3 on the following page successfully explains the steps in the generic benchmarking process.

Figure 1.3 The generic benchmarking process



Source: Hines P. 1994. *Creating world-class suppliers*.

Although benchmarking starts with a competitive analysis, it does in fact go far beyond only that. While competitive analysis focuses on product comparisons, benchmarking looks beyond products to the operating and management skills that actually produce the product. Karlof *et al* (2001: 38) determined that the four key elements of benchmarking are:

- A survey: How is it (the current business processes and procedures) performed now?
- The comparison: How are others doing it?
- Understanding: What is the explanation of the gap in performance?
- Improvement: Implementation and learning.

Kunz (2000b: 1 – 3) advises that the process of benchmarking should not only be used to define solutions required and measure solutions delivered based on industry's best practice, but also to provide an adjustment mechanism by highlighting company weaknesses that need to be improved. Benchmarking breaks down the paradigm of an ingrained reluctance of operations to change. It was further found that people are often more receptive to new ideas and their creative adoption when those ideas did not necessarily originate in their own industry (Human 2000: 18 – 30).

Another three important principles, which should be considered when implementing benchmarking as a channel management tool, are listed below:

(a) Predefine all processes and activities

In order to use benchmarking as an adjustment mechanism, it is important that all factors, such as the processes or activities to be benchmarked as well as the benchmarking partners are predefined as part of the outsource channel agreement.

(b) Benchmark against the best

It is important to note that benchmarking against companies of a similar size in the same industry is not enough to ensure success - it is also necessary to take into account the unique situations that prevail in a particular given organisation and the industry as a whole. Benchmarking studies are free to search out the 'best of a breed' of a process or skill, wherever it may be found.

(c) Implementation guideline

Benchmarking can be used as a safeguard for both customers and suppliers alike, especially in instances of substantial change to the existing outsource- or service level agreement. This means that the benchmarking tool can be used as a guideline for implementation of the change requirements.

To derive the most benefits from the benchmark tool, it is imperative that it be used in all stages of the business's dealings in the supply chain. Once the requirement versus the industry benchmark is plotted, the business can decide if it wants to outsource or rather perform the function of benchmarking internally. If used correctly, benchmarking will provide an effective and objective tool to maintain realistic standards in terms of channel aspects such as pricing and service level standards.

1.5 Contents of the thesis

The aim of the first chapter of this thesis is to create a background study for the rest of the content of the thesis. This thesis will be divided into six chapters. The information included in each chapter can be summarised as follows:

Chapter 1: The first chapter contains the problem statement, the purpose of the research and a very brief overview of current supply chain management processes and problems. It explains some of the current trends dominating the recording industry at present, such as business paradigms, business changes, integration and transformation. It also includes a summary of the research methodology of the thesis.

Chapter 2: The second chapter researches the current players operating in the local South African recording industry, which are the artist, the record company, the trade and the consumer.

Chapter 3: In the third chapter, the current supply chain processes of the South African recording industry are investigated and documented (MODEL

A). Much forward and backward integration occurs in this industry, with most record companies performing various channel and / or logistical functions in-house (*i.e.* procurement, warehousing, inventory management, sales and marketing, physical distribution, reporting, debt collection and others).

Chapter 4: In this chapter aspects relating to the supply chain of the hypothesis statement (MODEL B) are researched and documented. The two main concepts which receive attention are outsourcing and integrated supply chain management.

Chapter 5: The research methodology of the thesis is explained in detail in the fifth chapter. The properties of the research, the steps followed during the conduction of the research as well as the hypothesis statement is described in this chapter.

Chapter 6: The last chapter investigates a proposed new process for the local recording industry: the outsourcing of all non-core business activities to a third party logistics or supply chain management business partner (MODEL C). Ways in which value can be added to a business' operations through outsourcing its logistical supply chain, as well as ways in which to manage this outsourcing process are researched and discussed (refer to the theory of these processes as documented in Chapter 4). Thus, the last chapter will contain conclusions that were reached after completion of the research, as well as specific recommendations that flow from the research and conclusions.

The questionnaire that was used during various interviews is attached as Annexure I at the end of the thesis.

1.6 Summary

In order to remain a competitive player in the local recording industry, businesses may need to change their set ways and existing paradigms by relinquishing control and outsourcing some of their business operations to strategic partners. It will then become necessary to transform their management teams in order to include the effective logistical management of the total supply chain. It is widely believed that business strategies invariably fail as a result not of their design but of their execution and management. In order to be successful, a strong need for external orientation towards outsourcing and the management of the supply chain as a whole need to exist. Hughes *et al* (1999: 209) have identified a wide array of initiatives that need to be pursued in order to achieve the benefits derived from a responsive outsourcing supply chain management operation and they are listed below:

- Identify and simplify the key supply chain processes
- Eliminate all waste and non-value adding operations
- Rationalise and consolidate the external supply base
- Minimise stock holding
- Shift the emphasis from supply-push to demand-pull
- Streamline the warehousing and distribution functions
- Strengthen the information technology infrastructure to facilitate the flows of stock data and sales
- Reduce lead-times
- Develop internal and external capabilities

It is however important to note that optimising only one of these sub-processes is most unlikely to make a significant contribution to overall business performance. Equally, addressing only individual activities within a single process, such as sourcing, forecasting or benchmarking, will also have little impact. In order to be successful, transforming responsiveness needs an integrated and holistic approach. This new principle was researched as MODEL B and the tested results were incorporated into MODEL C in the final chapter.

CHAPTER 2

MAJOR PLAYERS OPERATING IN THE LOCAL RECORDING INDUSTRY

2.1	Introduction	34
2.2	Record industry terminology	35
2.2.1	Music publishing	35
2.2.2	Copyright	35
2.2.3	Publishing revenues	35
2.3	South African governing bodies	37
2.4	The artist	38
2.4.1	The individual artist or band	38
2.4.2	The signed artist or band	38
2.4.3	Artists' governing bodies	39
2.5	The record company	40
2.5.1	Main functions	40
2.5.2	Types of record companies	41
2.5.2.1	The Majors	42
2.5.2.2	The Independents	47
2.5.3	Record company governing bodies	48
2.6	The trade	49
2.6.1	Wholesalers	50
2.6.2	Dealers	50
2.6.3	Retailers	50
2.6.4	Independent stores	51

2.7	The consumer	52
2.8	Summary	58

2 MAJOR PLAYERS OPERATING IN THE LOCAL RECORDING INDUSTRY

2.1 Introduction

Chapter 1 of this thesis centred around the study of the supply chain management (SCM) process, in other words all the logistical aspects related to delivering a product to market. The first chapter also contained a basic overview of selected terminology associated with SCM, such as forecasting, benchmarking and achieving and maintaining a competitive advantage. The static and strategic components which influence the channel strategy were also discussed. Chapter 2 documents the local players which are currently participating in these SCM processes of the South African recording industry.

As in most other recording industries around the world, the South African industry consists of the following three major players:

1. The artist
2. The record company
3. The trade

These three groups, as well as the end-user, are discussed in this chapter (refer to points 2.4 to 2.7 below). Even though the end-user (the market) is not part of the above mentioned value chain, it is still briefly discussed as a player in the supply chain because of the vast impact this group has on all other players in the industry. The knowledge obtained here where put to good use when the current processes and procedures of the local South African recording industry (MODEL A) were researched and documented in Chapter 3.

2.2 Record industry terminology

Below three important terms are explained in anticipation of the discussion of the players in the local recording industry.

2.2.1 Music publishing

Music publishing is the business of acquiring and exploiting rights in musical compositions. It is a business based on the songs themselves as distinct from the records, films, commercials or other media in which they are used. Publishers are custodians of the song, *i.e.* the words and the music, and their business is to assure that they are heard and enjoyed.

2.2.2 Copyright

Copyright conveys to writers the exclusive legal right to be compensated for the use of their songs. Generally, the right to receive copyright royalties extends for the life of the writer, plus an additional 50 to 70 years following their death, depending on jurisdiction. Income generated by the use of a song is split between the writer and the publisher, with the publisher in most instances being responsible for the collection of the income on behalf of the writer, as well as for the distribution of their share.

2.2.3 Publishing revenues

Music publishers earn their revenue from licensing the right to use their songs, a right they have to the exclusion of the whole world. Every time a song is used or performed, the owner of the copyright must grant permission, a licence must be issued and a payment must be made. The more a song gets performed or used, the more income is generated for the publisher and songwriter. Although music publishing grew out of the sheet music business of the last century, the vast majority of publishing revenues today come from three sources, which are mechanical, performance and synchronization

royalties (www.risa.org.za/copyright). These three revenue sources are shortly discussed below:

(a) Mechanical royalties

The term 'mechanical' evolved out of the practice of converting sheet music into piano rolls that mechanically played the song - hence the name. It was a direct path from piano rolls to recordings. However, what has always remained certain is that each time a record is sold the publisher must get paid. The pace of growth of this type of income will be impacted by how fast the overall recorded music market is growing.

The average mechanical royalty across the world is about five percent of the retail price of a record. According to the South African Recording Rights Association Limited (SARRAL) and the National Organisation for Reproduction Rights (NORM), the mechanical royalty percentage in South Africa is six and a quarter percent of the retail price. In South Africa, popular *local* music generally retails between R59.99 and R89.99 per CD (compact disc) unit, which means that the average mechanical royalty payment will be between R3.75 and R5.62 (*i.e.* six and a quarter percent of the retail selling price per unit). From this calculation it can be concluded that a music publisher needs to sell many records before the income generated will add up to a meaningful number, especially since out of that six and a quarter percent the writer and other participants also have to be paid their share. Refer to a comprehensive breakdown of the PPD (price per dealer) and the retail-selling price in Chapter 3.

(b) Performance royalties

Historically, performance income was generated when a song was performed live on stage or played in a public place. Today, performance royalties cover a much wider range of uses, including when a song is broadcast on radio, television, in a cinema or even over the Internet.

(c) Synchronisation royalties

This is the third major and fastest growing source of revenue for the recording industry. As the name implies it involves the marrying of the song (the words and the music) with visuals - like television programs, advertisements and films.

2.3 South African governing bodies

Various bodies are responsible for the development and protection of the rights of the South African music industry. Three of the main organisations (as listed below) were contacted and interviewed in order to establish and confirm their roles and responsibilities in the local recording industry. The major organisations that look after the interests of the local industry and its players are listed below:

(a) South African Music Rights Organisation (SAMRO)

SAMRO is the largest of the five copyright organisations and it controls all broadcasting and public performing rights in South Africa.

(b) South African Recording Rights Association Limited (SARRAL)

SARRAL has been operating since 1963 and is a non-profit society looking after the rights of composers of musical works. SARRAL licenses and collects mechanical royalties (as discussed in point 2.2.3 above) on behalf of its members.

(c) National Organisation for Reproduction Rights in South Africa (NORM)

NORM is the association of South African music publishers and is a negotiating body representing the collective rights of its members. NORM has the authority to negotiate and collect royalties on all usage of copyrighted musical works in accordance with the mandates of its members. All South African music publishers, including SARRAL, are members of NORM.

2.4 The artist

The South African market is a colourful mix between countless young and upcoming individual artists, groups and bands; the more mature singers who have been around for a while and the really successful ones - who are unfortunately few and far between. For the purpose of this thesis, artists were divided into the following two major groups:

2.4.1 The individual artist or band

This group of artists have not signed a recording contract with a record company. They manage their own careers and also have to ensure that their product gets to the market, which entails the recording, manufacturing, selling and distribution of their albums. They also have to arrange their own concerts, tours and other public appearances. There are some advantages to choosing to follow this route - the major one being that the artists receive all profits from the sales of their titles themselves, and do not have to share it with a record company. On the other hand, the major disadvantage is that these artists often become 'jacks of all trades', because they are not able to concentrate purely on their core competence which is making music, but also have to get involved in all other logistical aspects of the manufacture, sale and distribution thereof.

2.4.2 The signed artist or band

This group of artists signed a recording deal or contract with a record company, for a specified period of time or for a specific number of albums to be recorded and released through the specific record company. In the current MODEL A, it is then this record company's responsibility to provide the funds and all other resources necessary to manage and market the artist or band's signed career. The entire supply chain management process (including aspects such as procurement, sales, marketing, physical distribution, debt collection and revenue distribution) is discussed in more detail in Chapter 3 (the current local supply chain or MODEL A) as well as in Chapter 6 (the outsourced supply chain model or MODEL C).

2.4.3 Artists' governing bodies

In point 2.3 above, certain bodies which control and protect composers, publishers and the music industry as a whole, were discussed. Various governing bodies also protect the rights of the South African music *artist*, mainly focusing their efforts on providing support for artists, as well as developing individual talents and the industry as a whole. Two of the more respectable local bodies performing these functions were researched and are discussed below:

(a) Musicians' Union of South Africa (MUSA)

MUSA was established on membership drawn from the former South African Music Alliance (SAMA), the South African Music Union (SAMU) and other non-aligned musicians and organisations. MUSA is a national representative body formed following musicians' demand for a union that would respond to economic, labour, legislative and development needs. According to their website (www.risa.org.za/sa_music_org), MUSA's mission is 'to ensure equitable development of South African music by promoting the development of musicians' professionalism and artistic competitiveness in a climate of economic fairness and striving for support - legislative and other that would enable and stimulate musical activity and excellence.'

(b) Music Industry Development Initiative (MIDI) Trust

Formed in October 1996, MIDI is a non-profit organisation that was formed to support growth and development of a vibrant and creative South African music industry and its artists. The focus of their activities is training and education, information, industry development and networking. It is a neutral organisation in the South African music industry with a wide network of industry stakeholders and other practitioners. The MIDI Trust is represented on various South African committees and associations. Its delegated representatives play important roles on the following three specific committees:

- The Anti-Piracy Committee of South Africa – a sub-committee of the Recording Industry of South Africa (RISA)
- The Standards Generating Body (SGB) of Music Industry Skills and Higher Education in Music
- The Technical Production Services Association

2.5 The record company

After the artist (discussed in point 2.4 above), the record company is the second player operating in the local recording industry. Different types of record companies, their main functions and governing bodies are discussed in points 2.5.1 to 2.5.3 below.

2.5.1 Main functions

The easiest way to define a record company, is to analyse their six main generic functions. These processes are currently all managed internally (the MODEL A supply chain):

(a) Contracting

Record companies contract or ‘sign-up’ individual artists or bands. These contracts are signed for a period of time, usually two years, or for a certain number of albums that the artist will release through the particular record company.

(b) Recording

Record companies are responsible for the recording of an album / albums in a recording studio. It involves many hours of rehearsing, recording, mixing, cutting and editing to achieve the finished end-product, *i.e.* the master CD (compact disc) which is to be replicated.

(c) Replication

This master CD is then duplicated by a specialised CD manufacturing plant. Two such local operations are *Compact Disc Warehouse* and *Sonopress*, both will be discussed in Chapter 3 when the processes of the current local supply chain are researched and documented.

(d) Sales and marketing

The finished copies are then sold into the trade by a sales team. A vast amount of marketing is necessary to create a demand in the targeted market, especially with the release of a new or unknown artist's material. This marketing effort also includes the production and manufacturing of marketing collateral, such as videos, posters, pamphlets, t-shirts and caps that must be produced to create mainly awareness and visibility. With big releases, large amounts of money are also spent on TV-, radio- and printed advertisements.

(e) Career management

The record company must manage the professional career of the artist or the band, and also control public appearances such as concerts and tours, in-store performances, photo shoots and autograph signing sessions.

(f) Royalty management

Very important is the management of the payment of all necessary royalties to the various governing bodies (as described earlier in this chapter), as well as to the artist or band. The calculation of these complex percentages and how they are distributed is discussed in Chapter 3.

2.5.2 Types of record companies

In South Africa, record companies are divided into two groups – the 'Majors' and the 'Independents'. Both groups are discussed on the following pages:

2.5.2.1 The Majors

There are currently five big international record companies operating in South Africa. In the local trade, they are commonly known as the ‘Majors’ or the ‘Big Five’ and they are listed and discussed below. Their historic input, as well as their contributions to shaping the worldwide recording industry as whole, are also reviewed.

(a) *Sony Music Entertainment Incorporated*

Of all the major and independent record companies, *Sony Music* has had the most revolutionary influence on the worldwide development of music, and making it available to the general public in a tangible format. *Sony Music*, as it is known today, can trace its beginnings back to the late 1880’s, to the *Columbia Graphophone Company* of Bridgeport, Connecticut (USA) – and the experiments of scientist Charles Sumner Tainter and his engineer colleague Chichester Bell, a cousin of the famous Alexander Graham Bell (www.sonymusic.com).

A patent was granted to Tainter and Bell on May 4, 1886. In place of the tinfoil that Thomas Edison had used in the development of his tinfoil phonograph a decade earlier, they substituted it for cardboard coated with wax on which a recording stylus traced sound patterns according to vibrations caused by impulses of sound projected on it.

The purchase of controlling interests for both Edison and Tainter and Bell’s patents, led to the founding of the *North American Phonograph Company*. The *Columbia Phonograph Company* was one of the subsidiaries across the USA that leased rights to operate regionally. By 1891, *Columbia* was the first company to offer a catalogue of phonographs for sale. By 1895, it was manufacturing hundreds of units per day and had a catalogue of more than 5 000 units by the end of that century.

Developments of both a technical and a musical nature became *Columbia* trademarks through the years. In 1904, the first discs were developed which played at 78 rpm (revolutions per minute). This was also the year that the pioneering of the double-sided record took place. By 1919 Americans were buying more than 25 million 78 rpm records every year, and the industry reported annual sales of USD150 million.

In 1926, *Columbia* took over the *Otto Heinemann Phonograph Corporation*, but then in 1934, *Columbia* was bought by *ARC-BRC (American Record Company – Brunswick Record Company)*. Four years later, in 1938, *ARC-BRC* was in turn purchased by *CBS (Columbia Broadcasting System)*.

A decade later, in 1948, *CBS* introduced the 33 1/3 rpm LP (long play record), which revolutionised the industry and soon became the accepted standard for sound reproduction. By 1955, production of the old 78 rpm disc had ceased.

In 1953, *CBS* launched a new label called *Epic Records*, which quickly developed into a formidable hit-making force in rock, pop, R&B (rhythm and blues) and country music.

In 1968, *CBS* formed a joint venture with *Sony Corporation* for the purpose of marketing *CBS* product alongside domestic Japanese product in Japan, Macao and Hong Kong. By 1978, worldwide sales for *CBS* records had reached USD1.2 billion, the first American record company to cross the billion dollar threshold.

Continuing its legacy of technological innovation, *CBS* helped introduce *Sony's* Compact Disc in 1982, which eventually superseded the 33 1/3 rpm LP. Simultaneously, *CBS* established music videos as a new and vital form of promotion for its artists and releases.

In January 1988, the *Sony Corporation* acquired *CBS* – and the company is known today as *Sony Music Entertainment Inc.* In January 1994, in acknowledgement of its worldwide growth and success, *Sony Music* reorganised into the four label groups which are still in use today: *Epic Records Group*, *Columbia Records Group*, *Relativity Entertainment Group* and *Sony Classical*.

(b) *Gallo Record Company*

Internationally the *Gallo Record Company* is a hybrid of the original *Gallo Record Company* that was launched in 1926 by Eric Gallo, and the *Gramophone Record Company (GRC)* founded in 1939 by music retailer Arnold Golembo. Today, *Gallo* is the exclusive licensee for *Warner Music International* and its affiliated companies and labels held under *Warner Brothers Records*, *Elektra Records* and *Atlantic Records* (www.gallo.com).

Gallo is the market leader in the South African music industry with an average market share of 25% over the past three years. Their head office is based in Rosebank, Johannesburg and they have two regional offices in Durban and in Cape Town. Their national distribution and fulfilment services are managed and controlled in-house through the *Gallo Distribution Centre (GDC)*.

Gallo Music Publishers (Africa) is the oldest and biggest music publishing business in Southern Africa and own more than 80% of South Africa's all-time best selling songs. Originally established as the *Music Publishing Company of Africa (Pty) Ltd* in 1950, *Gallo Music Publishers* boasts more than 50 years as South Africa's foremost publisher.

(c) *BMG (Bertelsmann Music Group)*

BMG is the number one distributor of music singles in the United States and has a number one or number two market share position for local repertoire in ten different countries around the world. *BMG Music Publishing* is the third largest record company and music publisher in the world, with *Bertelsmann AG* holding a 100% shareholding in the company. *BMG* is the global music division of

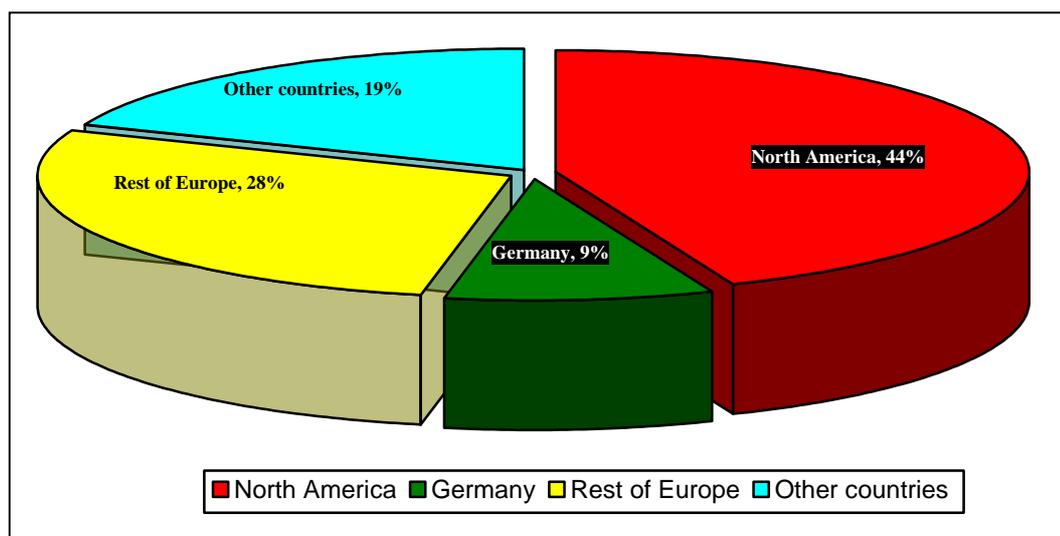
Bertelsmann AG, one of the worlds leading media companies. *Bertelsmann AG* has operations in 51 countries around the world with a workforce of more than 80 000 employees (as at the end of 2002). *Bertelsmann AG* revenues for the last fiscal year exceeded 18.3 billion euro (www.bertelsmann.de).

BMG owns more than 200 record labels, including the well known *J Records*, *Arista Records*, *Jive Records* and *Ariola* labels. Its three main business areas are record labels, music publishing and music distribution.

BMG is headquartered in New York in the United States of America, but have offices in 41 countries around the world, including South Africa. They have an employee force of more than 6 000 employees (as at the end of 2002). On February 23, 2003 at the Grammy Awards ceremony held in Madison Square Gardens, the National Academy of Recording Arts and Sciences awarded eight Grammy Awards to various *BMG* artists.

In the 2000 / 2001 fiscal year, *BMG* revenues exceeded 2.7 billion euro. Refer to Figure 2.1 below which depicts how this revenue was generated worldwide.

Figure 2.1 BMG revenues



Source: www.bertelsmann.com/divisions/bmg

(d) *UMPG (Universal Music Publishing Group)*

Generally known as '*Universal*', *UMPG* is headquartered in Los Angeles, California (USA), with more than 47 offices in 41 countries around the world (www.universalmusic.com).

The *Universal* catalogue owns record companies such as the prestigious *Rondor Music Catalogue* with more than 60 000 titles. Other well-known record companies in their stable are for example *Interscope*, *All Nations Music* and *Momentum Publishing*. *Universal* has contracted some of the twenty first centuries' most successful artists, including amongst others Shania Twain, U2, Bon Jovi, Prince, Westlife and Alanis Morissette.

(e) *The EMI Group*

EMI's biggest music recording division is called *Recorded Music*, which in turn consists of more than twenty smaller record companies such as *Angel Records*, *Capitol Records*, *Java Records* and *Virgin Records*. The *Recorded Music* label manages more than 1 500 artists and / or bands (www.emigroup.com).

EMI is the world's largest music publisher in terms of copyrights owned, controlled or administered, with rights to more than one million musical compositions and offices in 30 countries. *EMI* concentrates on discovering, promoting and nurturing gifted songwriters around the world, working with new and established writers to build a body of work to be appreciated by future generations and making the music of yesterday relevant to the audience of today.

EMI builds its music publishing business throughout the world by signing-on new songwriters, renewing existing contracts with songwriters and acquiring catalogues of existing compositions. *EMI* enters into agreements with composers and writers of musical compositions for the use of copyrighted compositions and songs. The company also seeks to ensure that songwriters' compositions are recorded and assists them in the further exploitation of their work. *EMI*'s successes enables the company to sign-on artists to its publishing arm even

when they are contracted to other record labels. An equally significant focus of the company is the acquisition and / or administration of catalogues of musical compositions from other music publishers and composers and authors who have retained or reacquired rights to such musical compositions. Catalogues owned or administered by *EMI* include *Screen Gems*, *Filmtrax*, *Virgin Music Publishing* and, through a 50% ownership of *Jobete Music*, the famous *Motown* black catalogue.

Catalogue is the bedrock of *EMI's* business. The publishing catalogue incorporates some of the most important songs of this century, songs that provide a consistent stream of income, year in and year out. In order to grow and prosper, *EMI* needs to continually add to and grow their catalogue. *EMI* believes that the art of identifying the next great writer and the next great song, is the single most important function they perform.

In looking to the future, *EMI* has also pioneered the use of technology to further its business. It was the first major music publisher to establish a web site (www.emigroup.com), the first to incorporate an advanced lyric search engine and the first to initiate the licensing process online.

2.5.2.2 The Independents

The second type of record company operating in South Africa, are the local independent record companies (or the 'Indies' as they are commonly known). They are much smaller than the above-mentioned international corporations and they contract mainly local artists.

It is worthwhile to note that lately, the number of *international independents* operating in South Africa have also been growing, especially record companies from the rest of the African continent now marketing and selling their music in South Africa.

Founded in October 1987, the biggest and most well known local independent record company is *Select Music* (www.select.co.za). They are headquartered in Johannesburg, South Africa and have a relatively big staff compliment, including several sales executives stationed throughout the country. They own two labels, namely *Crescendo* and *Fantastic*. Under these two labels, they own contracts with more than thirty of South Africa's leading artists. They also release compilation albums under the *Select* label, incorporating a wide mixture of music genres. Some of their best-selling 2003 and 2004 compilations in the following genres were:

- Afrikaans: “*DKNT Treffers*”, “*Ek sal jou nooit vergeet nie*” and “*Bokjol Somerpartie*”
- Dance: “*Goue Sokkie Treffers*”, “*Hie kommie partie*” and “*Gatswaai*”
- Country: “*Country Wat Skop*” (*volumes I and II*)
- Gospel: *Gospel “Karaoke Treffers”* on DVD
- Instrumental: *Sweetest Sax, Bagpipe Favourites, Piano Moods* and “*40 Kitar Treffers*”

Select Music Distribution (SMD) claims to be the biggest distributor of Afrikaans music. They distribute the titles contracted under their own two labels (*Crescendo* and *Fantastic*), and also manage the local distribution of the CD's of various other companies, e.g. “*Laurika Rauch Produksies*”, *Jamca Rythmics* and *Jump Productions*.

2.5.3 Record company governing bodies

According to a statement on their website (www.risa.org.za), the Recording Industry of South Africa (RISA) is ‘committed to improving the state of the South African recording industry and promoting and safeguarding the interests of all member record companies, no matter what size’. RISA is also known for the following two main high profile activities:

- Hosting the annual South African Music Awards

- Managing South Africa's official anti-piracy campaign (piracy is discussed in Chapter 3)

RISA's day-to-day work also includes many other important key aspects relating to the local industry, such as:

- a. The awarding of certificates of sales achievements by record companies and artists - at present album sales of 25 000 copies receives a gold certificate and 50 000 copies sold is awarded with a platinum certificate.
- (b) Representing the local recording industry internationally.
- (c) Providing information and research.
- (d) Establishing and applying ethics and standards throughout the country.
- (e) Making representations on key issues affecting the recording industry as a whole.

Refer to Annexure A at the end of this thesis for a full overview of RISA's functions as well as their detailed strategic objectives. Annexure B contains the current RISA membership list.

2.6 The trade

The third player in the local music industry is referred to as 'the trade'. The trade (the targeted market) buys finished goods – *i.e.* CD's (compact discs), tapes, videos, and DVD's (digital versatile discs), directly from the above-mentioned major or independent record companies, or sometimes from each other (dealers buy from wholesalers). They add a substantial mark-up unto the product and then sell it on to the public. The four types of South African traders are:

2.6.1 Wholesalers

The main characteristic of a music wholesaler is that it buys in bulk, with the main purpose of selling-on to other buyers in the trade. Because of the large amount of units it buys on an almost daily basis, it has the most bargaining power and generally receives the best prices from the record companies - they are thus mainly price driven. It sells goods directly to the public out of its factory-like warehouses, but its main objective is to be a 'middle-man' and sell on to other dealers.

The biggest South African music wholesaler is *Reliable Music*, operating out of Crown Mines in Johannesburg, Gauteng. They carry huge amounts of stock, often more than R30 million worth. In a personal interview with the Managing Director of *Reliable*, he stated that he himself is personally responsible for all the buying of stock from record companies. The *Reliable* client base consists of hundreds of small dealers and independent stores situated as far away as the Northern Cape, Limpopo and the Free State.

2.6.2 Dealers

Music dealers buy either directly from a record company, or from the above-mentioned wholesalers. They are also price driven, and will buy from whoever can offer them the cheapest price. Examples of South African music dealers are *Music Moods* in Centurion (Gauteng), *Blue Note CD's* in Pretoria (Gauteng), *Ziggy's* in Potchefstroom (North West province) and *Planet CD* in Bellville (Western Cape).

2.6.3 Retailers

Retailers or chain stores buy exclusively and direct from record companies. They have one head office with many outlets throughout the country, often also in South Africa's neighbouring countries. They are more service driven, and their required lead times are very short. Well-known local examples are:

- *Musica*, headquartered in Cape Town with 130 outlets in South Africa, and various more in the neighbouring countries (www.musica.co.za)
- *Look & Listen*, headquartered in Bedfordview, Johannesburg with ten outlets nationwide (www.lookandlisten.co.za)
- *CNA* with about 150 outlets in South Africa which sells music (*CNA* has consolidated their service offering and some stores now sell for example only books and games, others only stationary and greeting cards)
- *CD Warehouse* with three outlets situated in Gauteng and in Kwa-Zulu Natal

Retailers advertise aggressively. Since they all generally carry the same music titles (same *Product*) at the same *Price*, they focus mainly on the other two “*P*’s” of marketing to differentiate themselves from their many competitors, being *Place* and *Promotion*:

- (a) *Place*: they are situated in well-populated and frequently visited shopping centres or malls and they try to create an exciting shopping experience with attractive store interiors, multi-coloured banners and posters and loud music.
- (b) *Promotion*: they advertise aggressively, spending millions of rands on television, radio and press advertisements.

2.6.4 Independent stores

These so-called ‘mom and pop stores’ operate on a much smaller scale than the previous three groups. They generally buy very small quantities of stock, either from a record company or from the above mentioned wholesalers. They buy specific for their local demand and keep as little stock as possible. They have very little bargaining power and generally have to pay much higher prices than any of the other players in the trade. Many of them do not sell music exclusively, but stock a vast array of goods like radio’s, electrical appliances, cellular phones and cheap jewellery.

2.7 The consumer

The South African public is known for its diversity in preferring different kinds of music. Examples of some of the more well-known and popular genres are: classical, rock and pop, rap, dance, hip-hop, soul, R & B (rhythm and blues), 'kwaito' and gospel. Local and international music sales for the past five years are listed in tables 2.1 to 2.3 on the following pages (www.risa.org.za). In Annexure C at the end of the thesis a pie-chart illustrates the average monthly breakdown of South African local sales.

Note: Totals in the table below are retail sales values in rand values, for all music formats, *i.e.* including all music albums, CD's, cassette tapes, music videos and DVD's.

Table 2.1 Total sales of all music titles (both local and international) in the South African market (rand value)

MONTH	1999	2000	2001	2002	2003
January	23 285 368	15 718 209	21 017 281	26 410 892	27 776 668
February	35 150 873	31 417 150	32 646 952	43 206 943	36 396 740
March	40 938 326	55 552 560	49 660 142	62 262 134	58 719 029
April	44 287 534	44 036 305	39 451 052	46 292 317	55 702 620
May	47 632 143	40 482 756	43 052 979	63 174 187	62 167 852
June	50 916 237	44 167 674	54 973 463	38 428 747	46 520 247
July	59 761 445	39 980 799	36 033 447	39 882 772	39 781 110
August	46 843 987	42 852 377	47 238 765	55 949 396	45 387 838
September	54 450 318	55 685 776	44 919 351	54 434 403	56 588 661
October	79 611 521	67 286 379	55 368 435	77 918 077	83 612 599
November	99 305 825	80 771 138	98 292 158	116 401 082	94 914 109
December	110 489 014	88 564 560	86 877 202	79 977 792	97 444 371
TOTAL	692 672 582	606 515 883	609 531 227	704 338 742	705 011 844

Source: www.risa.org.za

Table 2.1 on the previous page contains the combined local and international retail sales figures, in rand values, of all music formats sold in South Africa over the last five years. An analysis of these combined sales figures led to the following conclusions:

- (a) Total music sales over the last five years have remained fairly constant, between R606 million and R706 million worth of sales per year. As discussed later in this chapter (refer to tables 2.4 and 2.5 below), this is due to a combination of the *increase* in local sales figures in conjunction with the *decrease* in international sales figures. Annexure D at the end of the thesis contains an additional graph depicting a breakdown of the separate local and international sales figures.
- (b) In 2002, 17 341 543 units were sold at a retail sales value of R704 338 742. This implies a sales value of R40.62 per unit. In 2003, 17 002 326 units were sold for a total of R705 011 844, which calculates to a sales value of R41.47 per unit (www.risa.org.za). Note that this retail sales value is an average amount for all music formats, including all music albums, CD's, cassette tapes, music videos and DVD's. This slight increase in the per units sales price (from R40.62 to R41.47), is mainly due to inflation and an over-all rise in consumer prices.
- (c) These combined sales values are relatively seasonal, with the highest sales occurring in the months of November or December, the traditional Christmas holiday period in South Africa. Coinciding with a general and all over lower consumer spending rate, the lowest monthly music sales every year, occur in the month of January.

Analysis and interpretation of the retail sales figures of the amount of local content (*i.e.* South African) music titles sold in South Africa displayed in table 2.2 on the following page, can also lead to various deductions and conclusions. These are discussed on the next pages:

Table 2.2 Local sales in the South African music market (rand value)

MONTH	1999	2000	2001	2002	2003
January	4 800 701	2 693 183	4 302 765	4 694 663	7 269 979
February	6 392 817	5 373 404	4 650 610	10 804 655	8 826 768
March	10 809 180	11 736 780	13 126 310	18 203 848	16 335 827
April	11 565 955	11 363 190	10 567 923	10 066 954	16 052 359
May	8 987 974	9 922 656	9 307 445	12 348 093	19 808 022
June	8 839 601	9 406 241	11 086 540	11 526 455	14 179 687
July	11 537 078	9 639 913	9 527 653	12 820 056	13 343 187
August	10 296 928	10 493 141	12 731 181	17 871 691	14 773 606
September	13 877 709	13 461 647	10 571 982	18 238 744	21 647 709
October	15 153 251	17 541 077	15 905 602	21 519 406	26 807 015
November	22 013 989	18 262 704	27 133 004	29 447 791	30 241 606
December	24 199 236	19 243 549	27 895 289	24 623 581	35 805 200
TOTAL	148 474 419	139 137 485	156 806 304	192 165 934	225 090 965

Source: www.risa.org.za

An analysis of the local sales figures led to the following conclusions:

- (a) In complete contrast to worldwide figures, the sales of local South African music have *increased* over the last couple of years.
- In 2000, the sales amount of local music was just nearly R140 million and in 2001 just more than R156 million, which is an increase of almost R16 million worth of sales in the one-year period
 - In 2001, the sales amount of local music was just over R156 million and in 2002 just more than R192 million, which is an even greater increase of almost R36 million in the one-year period

- From 2002 to 2003, the local sales figure went up again, with nearly R33 million worth of sales (refer to the data in the table above)
- (b) In 2002, 7 390 800 units were sold at a total retail sales value of R192 165 934. This implies a sales value of R26.00 per unit, which is an average figure for all music formats. In 2003, the sales value was R27.06 per unit (refer to the data in the table above). This unit sales amount is very low compared to worldwide markets, mainly because of the large amount of cassette tapes still sold in the South African market, which has a much lower retail sales price than for example CD's or DVD's. However, the slight increase in the per units sales price (from R26.00 to R27.06), is mainly due to the fact that less cassette tapes are now being sold in South Africa whilst more CD's and DVD's are being sold at a higher sales value.
- (d) The sales are highly seasonal, with the highest sales always occurring in the month of December (the traditional Christmas holiday period). Coinciding with a general and all over lower consumer spending rate, the lowest monthly music sales every year, occur in the month of January.

Refer to table 2.3 on the following page for a breakdown of international music titles sold in South Africa. The retail sales figures of international music albums sold in South Africa are interpreted as follows:

- (a) In South Africa, as in most other countries around the world, the sales of international music have steadily *decreased* over the last couple of years. Although sales figures in 2002 (+/- R512 million) were slightly higher than in 2001 (+/- R453 million), international music sales dropped again in 2003, not even reaching the R500 million mark. Annexure D at the end of the thesis contains an additional graph depicting a breakdown of the separate local and international sales figures.

Table 2.3 International sales in the South African music market (rand value)

MONTH	1999	2000	2001	2002	2003
January	18 484 667	13 025 226	16 714 516	21 716 229	20 506 689
February	28 758 056	26 043 746	27 996 342	32 402 288	27 569 972
March	30 129 146	43 815 780	36 533 832	44 058 286	42 383 202
April	32 721 579	32 673 115	28 883 129	36 225 363	39 650 261
May	38 644 169	30 560 100	33 745 534	50 826 094	42 359 830
June	42 076 636	34 761 433	43 886 923	26 902 292	32 340 560
July	48 224 367	30 340 886	26 505 794	27 062 716	26 437 923
August	36 547 050	32 359 236	34 507 584	38 077 705	30 614 232
September	40 572 609	42 224 129	34 347 369	36 195 659	34 940 952
October	64 458 270	49 745 302	39 462 833	56 398 674	56 805 584
November	77 291 836	62 508 434	71 159 154	86 953 291	64 672 503
December	86 289 778	69 321 011	58 981 913	55 354 211	61 639 171
TOTAL	544 198 163	467 378 398	452 724 923	512 172 808	479 920 879

Source: www.risa.org.za

(b) In 2002, 9 950 743 units of international music were sold at a total retail sales value of R512 172 808. This implies a sales value per unit of R51.47, which is an average retail sales value for all music formats. In 2003, the sales price per unit was even higher, at R55.26 per unit (refer to the data in the table above). It is clear to see how much higher this per unit value is compared to the unit value of local music of R27.06 per unit. The main two reasons for this difference are:

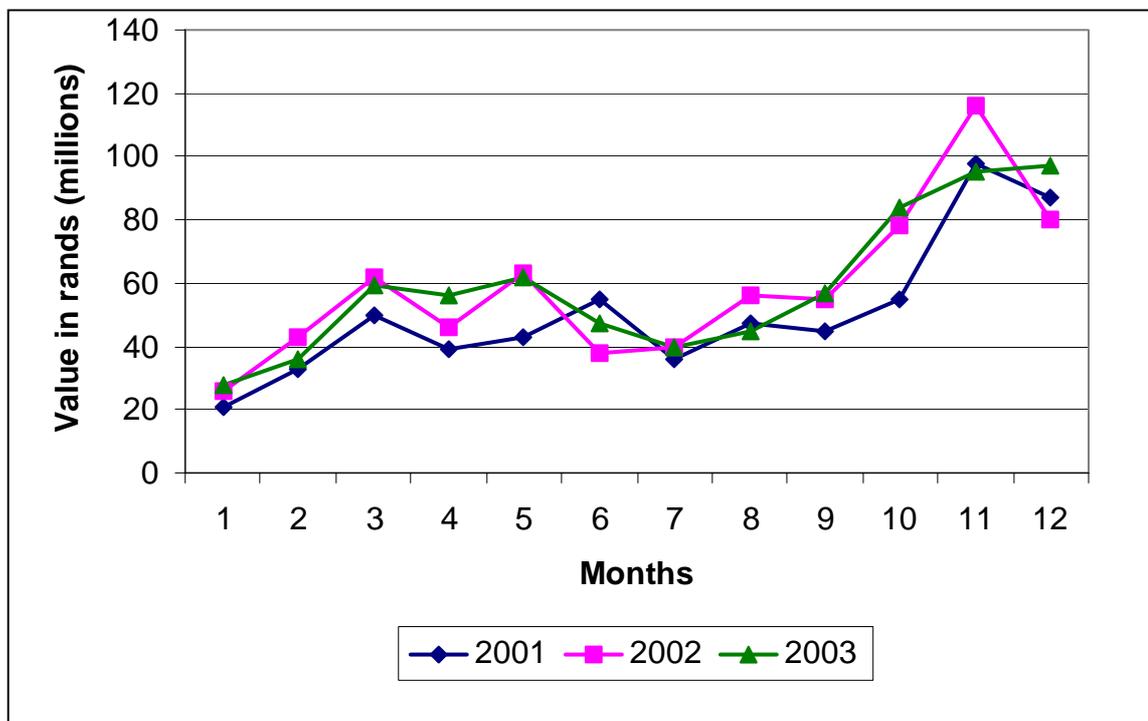
- A substantial number of local music is still sold as cassette tapes with a very low retail price, whereas international music is sold as CD's or DVD's which have a much higher selling price
- Even when local music is sold in a CD or DVD format, it still retails at a lower price when compared to a CD or DVD released by an international

artist. The average RRP (recommended retail price) of a local artist’s CD is between R49.99 and R89.99, while international music is sold on average between R109.99 and R149.99 per CD for locally manufactured units. Imported units have an even higher sales value.

- (c) These sales are also relatively seasonal, with the highest sales occurring in either the months of November or December. The slowest sales month every year remains the month of January.

Figure 2.2 below depicts the sales curve of the combined local and international sales values over a three-year period. With the sales of local music increasing, and the sales of international music decreasing, the end-result is a relatively steady sales figure over the last four years. Once again notice the distinct increase in music sold over the year-end holiday period of months 11 and 12 (*i.e.* the seasonal curve with increased sales in the months of November and December).

Figure 2.2 Graph of South African music sales



Source: www.risa.org.za

2.8 Summary

The second chapter of this thesis focused on the three major players operating in the current local recording industry - being the artists, the record companies and the trade. The consumer (the market) was also discussed. Whilst secondary research was performed to obtain specific information relating to these players, the emphasis was on the gathering of primary research data. Artists, record companies and music dealers were contacted, telephoned, e-mailed and various personal interviews were conducted by the author, with these players, in order to obtain personal and educated information relating to their industry (refer to the sources of knowledge in Chapter 5, point 5.4.3.2).

Chapter 3 investigates how these players are currently interfaced to supply their product to the end-user (MODEL A). The seven main processes that are currently in use are researched and documented (*i.e.* manufacturing, warehousing, marketing, selling, physical distribution, debt collection and the management of receivables). Principles of the well-known SCOR methodology (Supply Chain Operations Reference model) are also included (www.supply-chain.org).

CHAPTER 3

MODEL A:

THE CURRENT LOCAL SUPPLY CHAIN

3.1	Introduction	61
3.2	The manufacturing process	61
3.2.1	Just-In-Time manufacturing	61
3.2.1.1	Just-In-Time principles	62
3.2.1.2	Information technology	63
3.2.1.3	Customer service	63
3.2.2	Management Information Systems	64
3.2.3	Compact disc manufacturing	65
3.2.3.1	Principles of CD manufacturing	65
3.2.3.2	Compact Disc Technologies	67
3.2.3.3	Sonopress SA	67
3.3	Warehousing and distribution	68
3.3.1	Receiving	68
3.3.2	Picking	69
3.3.3	Physical distribution	69
3.4	Marketing	70
3.5	Selling	71
3.5.1	Sales executives	71
3.5.2	Music For Pleasure	71
3.6	Debt collection	73

3.7	Management of receivables	74
3.7.1	Ad Valorem duty	75
3.8	Piracy	76
3.8.1	Piracy definitions	77
3.8.2	The effects of piracy	78
3.8.3	The Counterfeit Goods Act	79
3.9	Summary	80

3 MODEL A: THE CURRENT LOCAL SUPPLY CHAIN

3.1 Introduction

This thesis concentrates on the conditions in the local South African market, as well as the production, selling and distribution of local South African music. The management of the local supply chain and the way in which it is *currently* operating in South Africa, is referred to as MODEL A, which is discussed here in Chapter 3. An alternative outsourced supply chain management model is researched and evaluated as the hypothesis statement in Chapter 5 and is referred to as MODEL B. The new outsourced supply chain management model is documented and explained under the conclusions and recommendations in Chapter 6 (MODEL C).

As a background study, six main processes (logistical processes and others) which are currently performed by a record company, but which do not necessarily form part of its set of core competencies, are discussed below (refer to points 3.2 to 3.7). These six processes are discussed throughout the thesis and in all three models (MODELS A, B and C) and are:

- The manufacturing process
- Warehousing and distribution
- Selling
- Marketing
- Debt collection
- Management of receivables

3.2 The manufacturing process

3.2.1 Just-In-Time manufacturing

In the competitive recording industry, the record company must first determine the existence of a probable expected consumer demand, before issuing an order to have

stock manufactured. Fortunately, it is possible for record companies to influence this expected demand through extensive marketing and visual advertising campaigns. The tastes of music listeners (the consumer or end-user) are very varied and change constantly. A title that might be selling thousands of units in one month may have nearly no sales in the following month. This is the main reason why record companies cannot afford to manufacture stock that might not sell – no company can afford to have their capital tied-up in un-sellable or obsolete stock.

3.2.1.1 Just-In-Time principles

Just-In-Time (JIT) is a manufacturing concept of meticulously planned logistics and distribution operations, which helps to reduce stock, lead times and therefore, costs. Especially in the last two decades of the previous century, JIT as a business principle was widely researched and evaluated by various international authors (Bicheno 1991: 1 – 5; Fawcett, McLeish & Ogden 1992: 82 – 84; Cheng 1996: 1 - 10). With the pressures of increased competition, accompanied by the possible expected lowering of product costs and selling prices, it is crucial that materials, components and end-items are at exactly the right place at exactly the right time.

JIT creates a pull mechanism in the supply systems, whereby goods are drawn through the chain by a demand (or an expected demand) for products, rather than being pushed through to form work-in-progress or safety stock. The main prerequisites for its implementation are short, dependable lead times and high levels of quality (Johnson & Wood 1996: 69 – 73, 173, 327 – 328; Hugo & Van Rooyen 1997: 58 – 61). These ingredients reduce the need for stockholding for reasons of unpredictable demand, interrupted or delayed supply and poor quality. Fortunately, both the two pre-requisites mentioned above (*i.e.* short dependable lead times and high levels of quality) are present with the manufacture of a compact disc (CD). The two major South African CD manufacturers are discussed later in this chapter.

3.2.1.2 Information technology

Information technology (IT) systems which entrench JIT manufacturing disciplines in their management information systems (MIS), will help all South African industries weather the onslaughts of a slow or unpredictable economy, low customer spending and cheaper imports. At the same time, IT will also help to open doors globally - mainly through improved communication between different companies operating in different industries in different countries around the world. According to Clague (2000: 1 – 2) industries need to operate smarter and leaner, and must be flexible to meet customer demands - this can only happen with the support of IT systems that have been developed to meet all customer requirements (refer to the discussion on the customisable MIS developed by SAP in point 3.2.2 below).

When IT is implemented to facilitate the JIT operation, the whole communication chain has to become far more dynamic and reliable. Some players in the recording market have burnt their fingers because they tried to adapt generalised manufacturing systems to their needs, rather than opting for a specialised system. The key concerns are manufacturing and delivering on-time to their customers' specifications (*i.e.* meeting the trade's demands) with tightly defined cost criteria.

3.2.1.3 Customer service

One of the main causes of loss to a record company is late delivery into the trade (*i.e.* to the record company's customer), since goods are then returned or sometimes not even received. A classic local example is the music wholesaler *Reliable Music* in Johannesburg (as discussed in Chapter 2 under point 2.6.1). In a personal interview with the Managing Director and sole buyer at *Reliable*, he explained that his store only accepts deliveries that are delivered within 48 hours of placing his order. No late deliveries are accepted and the record company will have to cancel the order and lose the sale if they do not deliver before the deadline. It is thus imperative that goods be received and despatched on time – Clague (2000: 1 – 2) believes that this can only be

achieved if management at all levels in the company have accurate information on which to base their dynamic just-in-time decisions.

It is important to note that JIT cannot be applied to every single title being produced, particularly where the demand is seasonal (*e.g.* certain seasonal gospel albums which sell only in April during Easter, or in December at Christmas time). It is however still used in many areas of procuring or purchasing raw materials or components, as well as in general inventory management and distribution.

The basic principle of JIT is to have goods delivered exactly where and when required, literally just in time to make the next move along the supply chain, which is usually the distribution process into the market - this can only be achieved by detailed forward planning and extensive use of information systems. It is not merely a particular method of distribution, but a total logistics concept that, if conscientiously implemented throughout a supply chain, means drastically reduced inventory and costs as well as an improvement in levels of service. All record companies need to recognise that JIT is an extremely useful business technique, and should use it accordingly, in order to improve their value-added service offering to their clients.

3.2.2 Management Information Systems

It is imperative that every business operating in a supply chain uses IT to employ a customised management information system (MIS) to manage its entire business operation (Lynch 2000: 15 – 16). Such a software program will control all processes in its chain, from procurement right through to sales, distribution and debt collection.

Founded in 1972, *SAP* is the recognised leader in providing collaborative business solutions for all types of industries and for every market in the world. Headquartered in Walldorf (Germany), *SAP* is the world's largest inter-enterprise software company. *SAP* employs about 30 000 people in more than 50 countries (www.sap.com/company), including South Africa.

‘mySAP Business Suite’ is a comprehensive business solution developed by *SAP* for today’s business economy. Its main function and advantage is that it allows employees, customers and business partners to work together successfully. ‘mySAP Business Suite’ is open and flexible, supporting databases, applications, operating systems and hardware from almost every major vendor. By deploying this technology, services and development resources, a business can have access to valuable information resources on which to base its JIT, forecasting, benchmarking and other management decisions. The program will also help to improve supply chain efficiencies (from procurement right through to delivery and debt collection) - this will in turn build stronger customer relationships and improve customer service.

3.2.3 Compact disc manufacturing

The first step in the processes of physical supply chain management is the manufacturing of stock. Of the various music formats currently being sold by South African record companies, the well-known CD (compact disc) is the most commonly used and sold music format at the moment - refer to its introduction into the market in 1982 by the *Sony* record company (as documented in detail in Chapter 2).

3.2.3.1 Principles of CD manufacturing

Most local and global CD manufacturers around the world adhere to the same general set of uniform standards. *Sonopress SA*, one of the biggest CD manufacturers in South Africa, has listed the following four important principles on its company website (www.sonopress.co.za):

(a) Lead-time

Under normal circumstances, a CD manufacturer usually quotes a ten working-day lead-time for all new orders placed (where glass mastering is required), and five working days for a repeat order. Refer to the *Sonopress* price list in Annexure E where the glass mastering process is described. This standard time

frame is calculated from the receipt of all necessary components, which generally include the following:

- The input medium *i.e.* the master CD (which was produced in a recording studio) and which is to be replicated
- The silkscreen label print positives for the printing on the CD itself
- The chromalin for colour-proofing the printing
- The printed packaging *i.e.* the front booklet and back inlay which are to be inserted into the CD jewelcase (the plastic casing)
- An official order with a PO (purchase order) number
- All the necessary copyright clearances, licences or agreements
- The *Ad Valorem* disclaimer (refer to the explanation on the *Ad Valorem* duty in point 3.7.1 below)
- A 50% deposit (this up-front payment is usually only required with new orders from new and unknown clients)

(b) Quantity variances

The final invoiced quantity may vary up to five percent from the client's original order quantity. This allows for process set-up, as well as for any rejects and manufacturing variances that may occur during the automated processes used to replicate discs.

(c) Printing

The disc label is printed using a complex and automated silkscreen print process. It is important that the client provide positives that conform exactly to the CD manufacturer's specifications.

(d) Packaging

Printed paper components for packaging usually consists of a booklet that is placed in the front of the jewelcase (the plastic casing), and an inlay in the back, under the tray. As the packaging process is automated, it is once again essential that these components conform to the manufacturer's specifications. If not,

manual packing will be performed and an extra charge will be levied to cover the additional labour costs (refer to the *Sonopress* price list in Annexure E).

There are currently two major local CD manufacturers in South Africa, being *CDT* (Compact Disc Technologies) and *Sonopress SA*.

3.2.3.2 Compact Disc Technologies

Compact Disc Technologies (CDT) has been operational since February 14, 1991 and the company was created by a joint venture between two record companies: *EMI* and *Tusk Music*, to fulfil their demand for local manufacture in South Africa. *CDT* has a manufacturing plant and warehouse in Midrand (Gauteng) and their current annual output is approximately 15 million CD's, although they have an annual capacity of more than 30 million CD's.

According to the Marketing Manager of the major South African CD replicator *CDT*, (electronic mail received August 2003), their biggest local order run for a single music title was for the Elton John single CD '*Candle in the Wind*', the tribute album to the late Princess Diana. The total amount manufactured in South Africa was 340 000 units, with millions more sold worldwide.

3.2.3.3 Sonopress SA

The other major CD replicator, *Sonopress SA*, operates out of a factory in Kya Sands, Randburg, near Johannesburg (Gauteng). *Bertelsmann AG* (who also owns the *BMG* record company discussed in Chapter 2) demonstrated its confidence in the future of South Africa by investing in this new, state-of-the-art compact disc replication facility. Investment in the South African facility was approximately R40 million, and *Sonopress SA* has an initial capacity of more than ten million CD's per annum. However, the building is designed to accommodate process expansion to a future capacity of thirty five million CD's per annum (www.sonopress.co.za).

The manufacture of a CD is a very complex and intricate process. The record company must first create a CD master in its recording studios and this master will be delivered to the CD manufacturer, together with an order for a specific number of units to be manufactured. The CD master then undergoes a series of highly technological processes where after literally hundreds of thousands of the same unit can be replicated. Refer to Annexure E at the end of the thesis for a comprehensive *Sonopress* audio CD price list. The CD inlays or booklets must also be delivered with the original master CD, and they will be inserted into the jewelcase (the plastic casing), either by machine or by hand (depending on the nature of the printed inlay / booklet and any specific customer requirements – refer to the price list). These CD inlays or booklets are manufactured by independent printing companies such as *Artone* in Johannesburg, or *Creda Press* in Cape Town.

Lastly, the jewelcase is sealed with a plastic overwrap (also called ‘shrinkwrapping’), and any additional stickers (usually for marketing purposes) are placed on manually by employees working on a physical assembly line, where after they pack the CD jewelcases in standardised carton shipping boxes (also referred to as ‘shippers’).

3.3 Warehousing and distribution

3.3.1 Receiving

After the CD’s have been manufactured (more correct terminology would be ‘replicated’, ‘duplicated’ or ‘copied’), the finished product is delivered back to the agreed delivery address, *i.e.* either to the record company’s allocated premises, or straight back to the individual artist who had his own master CD manufactured. For the purposes of this explanation, we will accept that the order was placed by a record company and not by an individual artist.

The goods are generally stored in secure warehouses from where they will be delivered directly into the trade. Usually no additional work needs to be performed on the received product. For the best functionality and capabilities, these warehouses should be

operated and managed by means of the complex technological management information systems (MIS) which were discussed earlier, which can track and trace individual units from their arrival into the warehouse, up to their delivery to a re-seller in the trade.

3.3.2 Picking

The trade (music dealers, retailers and others) fax, phone or e-mail their orders through to the record companies' data capturers. When the order processors enter these orders into the MIS, the stock is made available on the system and it can be drawn for the specific order.

Warehouses are divided into bins, with different titles consigned to different bins. When an order is entered, the MIS will automatically print a *picking ticket* in the warehouse, informing the pickers of the title and quantity to be picked, as well as in which bin in the warehouse those specific units are stored.

3.3.3 Physical distribution

Packers then make up the 'parcel' that is to be delivered to the dealer who placed the order. These packages are generally accompanied by a delivery note (a proof of delivery note or POD), as well as by an invoice. The POD must be signed by the dealer's receiving personnel and must be returned to the record company's warehouse as proof of delivery and its receipt of the ordered goods.

Most retailers follow a central buying philosophy (*i.e.* all orders are generated, sent and then managed from their head-office). The ordered goods are then delivered to the head-office or to the receiving and distribution depot.

Some retailers however, like the South African company *CNA*, expect their orders generated at head-office to be delivered to each individual store – which means about 150 separate deliveries to the individual *CNA* outlets nationwide. Often only a very

small amount of units are ordered for small outlying towns with small populations and little buying-power – these deliveries are clearly very costly to the record company.

Other local retailers have set-up their own distribution depots situated throughout the country. *Musica* has three of these depots, strategically situated in Midrand (Gauteng), Cape Town (Western Cape) and Durban (KwaZulu-Natal). Orders for the three regions are also generated at head-office, but the record company only needs to deliver three bulk orders to the three centres – *Musica* itself will split the goods received and deliver it to their individual nation-wide stores.

3.4 Marketing

Around the world, the marketing of music artists and their titles have become a very specialised and very costly necessity. Even locally, record companies spend millions of rands each year to produce and pay for TV-, radio- and press advertisements. Intense competition in the market implies that marketers need to use both the ‘push’ and the ‘pull’ mechanisms to achieve the greatest demand for their product:

(a) Market push

Marketers ‘push’ the title into the trade by incentivising the product, offering invoice discounts and other special deals to the trade. This is called ‘below-the-line marketing’, because its costs do not get added up-front to the initial cost of the production of the album (refer to the split in the cost break-down in Table 3.1 on page 75). Examples of these are:

- ‘Buy ten units and get one unit free’ is the most widely used incentive to push more titles into the store. Record companies want to make sure that the racks of the dealers are filled with their product, so there can be greater visibility for their titles
- In-store appearances or signing sessions by the artist in the store, which also creates visibility and familiarity for the artist and the release

(b) Market pull

Marketers simultaneously strive to achieve a ‘pull’ effect from the market, *i.e.* create a demand or a call for a specific title. This ‘above-the-line marketing’ is included in the initial cost calculations and is achieved by targeting the market (the end-consumer) directly through the above-mentioned TV and other advertising campaigns.

3.5 Selling

3.5.1 Sales executives

The five major record companies all have dedicated, specialised and incentive-driven selling teams. These sales representatives usually earn a small basic salary and earn the bulk of their income from commission, an amount paid based on the number of units sold over a specific period of time. They have a very specialised knowledge of the music they sell. Record companies allocate their sales representatives in one of two ways:

- Purely by area, which means that the specific sales person must sell all genres of music to his / her allocated area, for example the Witwatersrand area, or the Western Cape area
- By area *and* by genre, meaning that the sales person only sells a specific *type* of music in his / her allocated area, for example only rap, hip-hop, jazz and blues into the KwaZulu-Natal area. If the record company has the necessary resources and manpower available, this more specialised approach is generally preferred

3.5.2 Music For Pleasure

Years ago, every major record company had a small internal division dedicated to the budget reissue of its own back catalogue (*i.e.* the marketing and selling of their old titles that are in a declining product life cycle phase). *Music For Pleasure (MFP)* saw an opportunity in the international market and got involved with the worldwide selling of the *EMI* back catalogue (www.vinylvulture.co.uk). At its inception in 1965, the ‘*Music*

For Pleasure Record Club operated out of Middlesex (United Kingdom), formed as a joint venture with the massive *Hamlyn Publishing House*. The company caused a mighty media stir by simultaneously releasing 78 different long play records with the bargain price tag of 12s. 6d. (twelve shillings and six pennies). In those days, the price for a new vinyl record was 32s.

In the early days, things didn't always run very smoothly with the new joint venture (JV) - for example neither *EMI* nor *Hamlyn* shouldered the responsibilities for royalty payments, because each company thought that the other one was handling and managing this responsibility. Despite all their problems, many records still made it out to the shops and *MFP* did very well as a so-called 'loss leader'. Around 1973, a parallel series of *MFP* releases mysteriously appeared under another label, the '*Sounds Superb*' banner, which resulted in *Hamlyn* pulling out of the JV deal.

Around the turn of the 1980's, *MFP* started to struggle financially, mainly because of rationalisation and mergers occurring throughout the major record companies. It was also felt that the Majors nearly destroyed their own industry in their efforts to generate cash to pour into the development of compact disc technology (refer to the discussion on the inception of the compact disc in Chapter 2). *MFP* then turned into little more than a distribution network, albeit one that spanned the globe.

Nowadays, the only evidence of *MFP* is to be found in South Africa, where it is a merchandiser of all music formats for the modern audio / video age. *MFP*'s function is to be a 'middle-man' between the record companies and the major South African retailers, e.g. *Pick 'n Pay*, *Makro*, *Game* and *Dion*. *MFP* buys product from the record companies, and then sells it on to the retailers. Its main value-added service offering is that it also merchandises the stock, i.e. it physically packs the stock onto the store racks, organises in-store marketing as well as advertisements in press and on television and radio. It performs in-store stock-takes and manages the re-ordering process.

In 1999, *MFP* was bought-out by the major record company *Gallo* (refer to the detailed discussion on *Gallo* in Chapter 2, point 2.5.2.1).

3.6 Debt collection

The collection of debt is discussed below, because it is another crucial process that currently needs to be managed and executed by a record company, even though it is not one of its core competencies.

After the record company receives an order from a wholesaler, dealer or retailer, various order details are checked and verified if necessary:

- (a) The financial status of the outlet that placed the order (*i.e.* payment terms, credit worthiness, outstanding amounts still overdue and other important financial aspects).
- (b) The correctness of the order, for example the verification of the completeness and correctness of the delivery address, the part-numbers of the titles ordered and any other relevant order details.
- (c) Verifying and checking for the correctness of the PO (purchase order) number.
- (d) Checking for stock availability on the MIS (management information system), of the particular titles requested in the order.

If there is no stock of that particular title on hand, the order goes onto back-order and more stock will have to be manufactured before the order can be executed. If the necessary stock is however available to fulfil the order, goods are picked and despatched from the warehouse, along with a delivery note or a POD (proof of delivery) and an invoice. The recipient of the goods signs the POD and keeps a copy for himself, along with the invoice.

It is then up to the record company's financial department, more particularly the debtors clerks, to collect the monies due.

3.7 Management of receivables

The money received from the sale of a single unit, has to be divided into many receiving channels. For one unit sold by a record company, a simple example of the split is illustrated in table 3.1 below. In this example, when manufacturing a thousand CD units and then selling them to a dealer at a PPD of R50.00 per unit, the cost and revenue breakdown can be explained as follows (refer to the table below):

- The total costs incurred by the record company (including manufacturing, marketing, sales, distribution, duties and royalties) are +/- R35.71 per unit, *i.e.* the total order cost is R35 710.00
- The balance of R14.29 (R50.00 sales price less the R35.71 cost price) is the record company's profit. If all 1 000 units are sold, the record company will thus make a profit of R14 290.00 on this released title

Table 3.1 Breakdown of the unit selling price of an average music CD

	TYPE OF COST	TOTAL COST	UNIT COST	PERCENTAGE OF COST
Glass mastering and testing	Manufacturing cost	R1 550.00	R1.55	3.505% of PPD
CD replication and CD label printing	Manufacturing cost	R3 790.00	R3.79	8.571% of PPD
Additional 2 colour print on the label	Manufacturing cost	R300.00	R0.30	0.678% of PPD
<i>Ad Valorem</i> duty	Manufacturing duty	R454.02	R0.45	1.018% of the manufacturing cost
Mechanical royalties	Royalty payment to governing body	R5 620.00	R5.62	6.250% of the retail selling price
Warehousing and delivery costs	Fulfilment fee	R500.00	R5.00	10.000% of PPD
Sales commission	Fulfilment fee	R500.00	R5.00	10.000% of PPD
Marketing	Marketing expense	R10 000.00	R10.00	20.000% of PPD
Artist royalty	Royalty payment to the performing artist	R4 000.00	R4.00	8.000% of PPD
TOTAL COST		R35 710.00	R35.71	

Source: Own research.

Note: In the example above, 1 000 units with a two-colour silkscreen print on the CD label were manufactured at *Sonopress SA* (refer to the generic Sonopress price list in Annexure E at the end of the thesis).

3.7.1 Ad Valorem duty

An *Ad Valorem* excise duty is levied on all audio components (CD's, cassette tapes, video's or DVD's), as well as on CD-Roms containing music, games or video clips. Copyright clearances for these audio components must be obtained from SARRAL and NORM (South African recording industry governing bodies described in Chapter 2). A copy of this clearance must in all cases be submitted to the CD manufacturer (*e.g.* *Sonopress* or *CDT*) when an order to manufacture is placed.

The *Ad Valorem* duty is payable to SARS (South African Revenue Service), and is payable whenever one of the above-mentioned music components are manufactured. This duty is calculated and payable on the manufacturing cost of the item, and not on the value or sales price of the component or the end-item.

Ad Valorem is payable exactly on the 25th day of the month, but only every three months for goods manufactured in the previous three month period, *i.e.:*

- January to March duties are payable in April
- April to June duties are payable in July
- July to September duties are payable in October
- October to December duties are payable in the following January

The *Ad Valorem* amount payable is calculated as follows:

1. Add the total amount of invoices made out to the principle over the applicable three month period (excluding VAT)
2. Add fifteen percent (15%) to this total - this amount equals **x**

3. **x** is multiplied by 0.07 and then equals **xy**
4. **xy** is the *Ad Valorem* amount payable to SARS

Below is an example of a fictitious *Ad Valorem* calculation:

Manufacturing invoices for the three month period (excluding VAT):

January 2003:	R190 000.00
February 2003:	R240 000.00
March 2003:	<u>R320 000.00</u>
TOTAL:	<u>R750 000.00</u>

$$R750\,000.00 + 15\% = R862\,500.00 \text{ (x)}$$

$$R862\,500.00 \times 0.07 = R60\,375.00 \text{ (xy)}$$

This means that a manufacturer (the record company or artist that placed the order) must pay R60 375.00 to the South African Revenue Service (SARS) as a duty or tax for audio components manufactured with a manufacturing cost of R750 000.00.

3.8 Piracy

Piracy is a problem that affects every sector of the music industry, especially in Africa and other Third World countries where it is not properly monitored and offenders are not properly prosecuted. Record companies, artists, composers, publishers, distributors and retailers all lose out when customers buy a pirate / counterfeit copy rather than a legitimate recording.

The occurrence of piracy is discussed because it is a major problem in world wide recording markets. Especially traditional record companies (as in MODEL A), that replicate their own stock and manage their own inventory, often do not have the necessary resources to fight this external threat. In the proposed outsourced model

(MODEL C), even though the third party supply chain management company will probably not be able eliminate piracy completely, the fact that it is responsible for the manufacture and management of all inventory and because it has more resources available, leads to the conclusion that it will be better equipped to control the unlawful manufacture and distribution of copyrighted merchandise.

3.8.1 Piracy definitions

Piracy is a term used to describe all varieties of unauthorised recording and can be broken down into the following five main categories:

(a) Simple Piracy

Simple piracy is the unauthorised duplication of an original recording for commercial gain without the consent of the rights owner. The packaging of the pirate copy is different from the original, and often of inferior quality. Pirate copies in this category are usually much cheaper than the original.

(b) Counterfeits

These are items that are copied and packed to resemble the original as closely as possible. The original producer's trademarks and logos are reproduced in order to mislead the consumer into believing that they are buying an original product.

(c) Bootlegs

This term describes the unauthorised recording of a live broadcast performance. The recording is then duplicated and sold without the permission of the composer, artist or record company.

(d) Internet Piracy

This type of piracy most typically takes the form of music being compressed and posted and transmitted globally via the Internet, without the authorisation of, or payment of any royalties to, those who invested in the creation of the recording.

(e) MP3 Piracy

MP3 is a format used for compressing audio files. MP3 files are generated as follows: a computer user inserts a standard music CD into the CD Rom drive of a computer. It then runs an MP3 software programme that will ‘rip’ the audio signals in the tracks on the standard CD and compress them into MP3 files. These files are stored on the computer’s hard drive and can then be copied onto CD-R discs. The difference between the original standard CD and the CD-R is that the CD-R will carry many more recordings because the music has been compressed. An MP3 compilation CD-R could carry more than 150 tracks – which is equal to around eleven normal music albums.

The Recording Industry of South Africa (RISA) claims that the sale of unauthorised copies of copyright works in the MP3 format is without doubt a criminal offence, and not a ‘grey area’ as some users would like to think (www.risa.org.za/piracy). Just because a consumer owns the CD doesn’t mean he also ‘owns’ the music. It is not allowed to put music on the Internet without permission of the copyright owners of the copyright in the sound recording and in the musical composition. It is a breach if sound recordings are uploaded or downloaded without permission of the copyright owners. Consumers should assume other people’s works are protected by copyright and can’t be copied or played over the Internet.

3.8.2 The effects of piracy

These are the four main effects related to the manufacture and sale of pirate music. Each of the four major players operating in the recording industry are negatively affected by the piracy of music:

(a) The artist

Firstly, the artist receives no royalty payments from pirated copies sold. When an artist does not also perform at concerts, on tours or at other public appearances, the income he or she receives as a royalty from the album sales is his or her only source of income.

(b) The record company

The record companies receive no return on its investments. It has invested money in the manufacture, marketing, sale and distribution of an artist's album, but will receive no money in return if the titles sold in the market are pirate copies. It will have lower sales figures and this all-together lower turnover may eventually even lead to staff retrenchments.

(c) The market

Dealers and retailers will not be able to compete with the low prices offered by the pirate merchants, even though they are often selling an inferior product.

(d) Consumers

Lastly, consumers will be buying copies of inferior quality. If tracks are missing or the sound quality is poor, the buyer will not be able to make any exchanges or receive any refunds. The consumer may even be contributing to organised crime syndicates that are heavily involved in international music piracy.

3.8.3 The Counterfeit Goods Act

The Counterfeit Goods Act (CGA) is now being utilised to fight piracy in South Africa. Members of the South Africa Police Service (SAPS), the Department of Trade and Industry (DTI) and Custom Officials are all empowered to seize counterfeit copies in terms of this law. Counterfeits include CDs, cassettes, MP3 and CD-R copies. The penalties when caught for piracy are very steep (www.risa.org.za/piracy):

1st Offence: Maximum fine of R5 000.00 or three years imprisonment or both for each counterfeit copy.

2nd Offence: Maximum fine of R10 000.00 or five years imprisonment or both for each counterfeit copy.

3.9 Summary

In Chapter 2 the major players operating in the local record industry were discussed. In Chapter 3 the classic way in which the entertainment industry processes are currently managed in South Africa (MODEL A), were researched and documented. In short, it can be summarised as follows: a record company will contract an artist or a band and will record an album in its recording studios. The record company will then have a certain amount of CD's, tapes, video's and / or DVD's manufactured of this recorded master CD. The record company will then warehouse, market, sell and distribute this title. After invoicing, debt will be collected and the received monies will be managed and allocated in the correct ways. Throughout this thesis, this supply chain management process is referred to as MODEL A.

As can be seen from this short summary, record companies have generally kept most or all logistical functions in-house, managing processes that are not at all part of their core competency - which is purely the recording and publishing of music. In Chapter 4, two processes related to logistical management, being outsourcing and integrated supply chain management, are researched and documented. The research methodology in Chapter 5 serves to design and describe the hypothesis statement researched as MODEL B. MODEL C then describes the new tested model derived from the hypothesis statement, and documents the research methodology applied to the development of the new streamlined and outsourced supply chain model.

CHAPTER 4

OUTSOURCING TO A THIRD PARTY

4.1	Introduction	82
4.2	Adding value through outsourcing	83
4.2.1	Outsourcing methodology	83
4.2.2	Collaborating with strategic business partners	86
4.2.3	Third-party logistics	88
4.2.4	Outsourcing integration driven by management	91
4.2.4.1	Management capabilities	92
4.2.4.2	Key success factors	93
4.3	Integrated supply chain management	96
4.3.1	Collaborating the supply chain	96
4.3.1.1	Present channel inefficiencies	96
4.3.1.2	Possible success factors	97
4.3.2	Supply chain integration	99
4.4	Outsourcing pitfalls	100
4.5	Summary	104

4 OUTSOURCING TO A THIRD PARTY

4.1 Introduction

When looking to break away from old business paradigms and move to a more streamlined and ultimately more profitable business alignment, modern companies can investigate the viability of outsourcing their non-core business activities to strategic third-party business partners (Lynch 2000: 1 – 6). Businesses that are open to this change must then adapt their current business paradigms and evolve in order to become more effective in their traditional operations – this can be achieved by opting out of the race to produce, manage and control everything in-house and rather outsource some non-core business activities to the above-mentioned third-party logistical business partners.

Chapters 2 and 3 of this thesis examined the players and processes of the local South African recording industry. Forming part of the literature study, Chapter 4 researches and documents two main aspects related to supply chain management (SCM):

- (a) How outsourcing can add value to a company and to a chain, while collaborating with strategic business partners. Third party logistics and the key success factors of the process are also discussed.
- (b) Integrated SCM and collaboration of the supply chain, present channel inefficiencies and possible success factors for the future are also researched.

These two aspects serve as background information supporting the hypothesis statement researched under the researched methodology of Chapter 5 and reads as follows:

“Record Companies in the South African Recording Industry should outsource all their non-core business activities to one strategic business partner.”

Performing all business functions in-house have become so complex and expensive to maintain, that outsourcing has become a viable option and in some cases, a sure means of gaining a competitive advantage. Previously companies would outsource for tactical reasons, such as a lack of technical or other skills and know-how. As will be seen in this chapter, the reasons for outsourcing now tend to be more strategic and driven by senior management (Nowicki in Language 2000: 2).

4.2 Adding value through outsourcing

4.2.1 Outsourcing methodology

Outsourcing is the practise of handing over the planning, management and operation of certain functions to an independent third party. Outsourcing methodology is essentially the embodiment of good practise in taking management decisions. The decision to outsource a business function needs to be the subject of a proper management process and not simply made on financial or technical grounds.

Many authors have defined the word ‘outsourcing’ or the outsourcing concept (Greaver 1999: 1 – 5; Linder, Cole & Jacobson 2002: 23 – 24). Rothery and Robertson (1995: 4 – 6) offer the following simple but clear definition on the process of outsourcing:

‘The *outsource* could be defined as a service outside the company acting as an extension of the company’s business but responsible for its own management, while *outsourcing* could be defined as employing an outside agency to manage a function formerly carried on inside a company.’

If a company wants to invite bidders to tender for the management and execution of one of the proposed outsourced processes, Rothery *et al* (1995: 39 – 40) suggest that the decision to outsource, as well as the implementation thereof, can successfully be reached by utilising a set of six business tools. These tools should help traditional record companies that are still integrated both backward and forward (*i.e.* still performing all

operational processes discussed in Chapter 3 in-house), to change their business paradigms and adapt the outsourced logistics model detailed in Chapter 6.

Phase One: Initiation

This phase identifies the scope of what is being considered for outsourcing, *i.e.* which one of the functions in the logistics chain will be outsourced. It sets criteria, initial milestones and other factors for initial decisions. It also allocates initial resources to start the project. According to secondary research, as well as several personal interviews (primary research), this phase can take between two and four weeks and since it is a strategic company decision, it should be initiated by senior management.

Phase Two: Assessment

This phase examines the feasibility of outsourcing, it defines the scope and boundaries of the project and reports on the extent to which the project will meet the criteria laid down above. This phase generally lasts between four to six weeks and can be executed by a functional manager who should deliver a feasibility study at the end of the assessment phase. This report should include, amongst other things:

- A summary on the current situation, *i.e.* current levels of service and current costs with regards to people, capital and overheads
- Information on the gaps between the current and the expected or desired service levels
- Any other relevant influences, be it internal (*e.g.* internal company changes) or external influences (*e.g.* market, industry or legislative changes)

Phase Three: Detailed planning

In this phase the criteria are set for the expected bids, whilst requirements are defined in detail. A shortlist for invitations to tender is

drawn up. This process can last up to ten weeks, where after a plan for the bidding process is developed, including tendering documentation, service descriptions, a strategy for supplier negotiations and the drafting of the SLA's (service level agreements). Refer to the proposed content and main elements of a SLA in Annexure F at the end of the thesis. Good preparation in this third phase will improve the quality of the received responses.

Phase Four: Contracting

In this phase a preferred contractor is selected as a result of the tendering process. It is important that a back-up supplier should also be identified. When complex processes or aspects are outsourced, the contracting phase can last up to three months. If however, only one third party outsourced partner is selected to manage all outsourced processes, this phase can be concluded in a much shorter time period. The above-mentioned SLA's should be discussed, the companies should reach agreements over all relevant aspects and should negotiate the final contract. A detailed plan must be drawn up for the transition of the outsourced processes to the new outsourced supplier.

Phase Five: Transition to the new service

The fifth phase establishes the procedures for the management of the newly outsourced function. It transfers formal responsibility for operations and also transfers staff and other assets if and where agreed. A detailed transition plan must be drawn up in which all management- and review procedures are documented. This is the phase where the handover of responsibility formally moves to the new outsourced supplier or service provider.

Phase Six: Management and review

The contract needs to be reviewed on a regular basis against the agreed levels of service (as per the established SLA). Any changes or additional requirements can be negotiated and implemented if and where necessary.

4.2.2 Collaborating with strategic business partners

Record companies operating in recording industries around the world are extremely suitable candidates for following the route of outsourcing. The core function of these companies is to record music and manage their artists - not to manage their entire supply chain and ultimately get their product to the market. Many record companies are also increasingly wary of the accelerated obsolescence associated with their industry. Time to market and customer service levels should be outstanding and managed and controlled by a dedicated team. The reality of these and other corporate management challenges is what is driving outsourcing trends in the world and this bodes well for supply chain management service providers and other logistics companies.

Important elements can be identified which should be seen as prerequisites to successful outsourcing agreements. There exists a definite need for accelerated delivery of relevant information to management in order for them to execute timeous and cost-effective decisions. There are many ways in which information can be used, manipulated and delivered. New technologies are constantly emerging that can offer substantially improved cost-to-benefit characteristics. Also refer to the discussion on information technology and management information systems in Chapter 3. South African companies are only now catching-up to their worldwide counterparts in realising the importance of information as a vital company asset and a core economic enabler of the new millennium.

Outsourcing has many benefits and various authors have listed them in their works (Rothery 1995: 3 – 10; Dash 2000: 8; Language 2000: 1 – 5; Lynch 2000: 7 – 16; Linder, Cole & Jacobson 2002: 24). Summed up below are some of the main

advantages that can be derived from outsourcing non-core activities to strategic business partners:

- (a) A stable budget in the form of a negotiated fee structure

When, for instance, a record company outsources the manufacturing of its end-item (*i.e.* the duplication of its recorded master CD), it will receive a fixed quote based on quantities and lead-times, from the chosen business partner. This will allow the record company to include this variable cost into a stable budget.

- (b) Service levels can be guaranteed

The company that spends more time developing the important relationships with its market – rather than performing repetitive administrative or other non-core tasks – is the one that will eventually enhance its long-term value in the eyes of the customer.

- (c) Access to scarce resources and specialised skills can be obtained

A company that possesses the skills to record music, may not necessarily possess the resources or know-how to distribute the records into the market. By outsourcing this non-core business activity, both business partners can concentrate on doing what they do best.

- (d) Increased flexibility to accommodate business changes and expansion

When needed, it is easier to change outsourcing partners than changing one's own internal operations.

- (e) Focus on the core competency

Most importantly, the ability to concentrate on the business' core functions will be obtained.

However, Dittberner (2000: 1 – 2) warns that outsourcing does not guarantee success. Although outsourcing brings innovation and a fresh approach to all business activities, the need for a cultural fit must not be underestimated. The delivery capability of the

service provider needs to be assessed meticulously. Companies will do well to ensure that the outsourcers they select become more than mere solution providers – they must in fact be seen as critical links in the products and services delivered to clients.

4.2.3 Third-party logistics

Integration of functions and the development of process management will guide many organisations to decisions about internal and external sourcing. As was explained in Chapter 1 (refer to point 1.3), company philosophies and paradigms influence many decisions of this nature.

If distribution for example, is truly seen as a part of the marketing function, the control of distribution activities may be integrated into the marketing function, while only the physical distribution functions are then outsourced to a third party service provider.

In order to determine the viability and profitability of the outsourcing concept, many internal issues need to be considered. Pienaar (2000: 1 – 2) highlights the importance of evaluating the following six critical areas:

- (a) Evaluate the company's core competency, in order to determine characteristics such as what the company specialises in, where and how it makes its profits and where its human resource strengths lie.
- (b) Evaluate the company's primary products and whether it is possible to outsource its manufacture, warehousing, sales or distribution.
- (c) Evaluate and quantify the possible future growth prospects of the company which will aid in the outsourcing decision, for example capital expenditure and others.
- (d) Review any and all current collaborations with suppliers and clients.

- (e) Evaluate the company and employee flexibility (with regards to management structures, company paradigms and others).
- (f) Decide on timeframes that need to be worked towards (with regards to the implementation process, as well as the accompanying changes in the working processes and procedures).

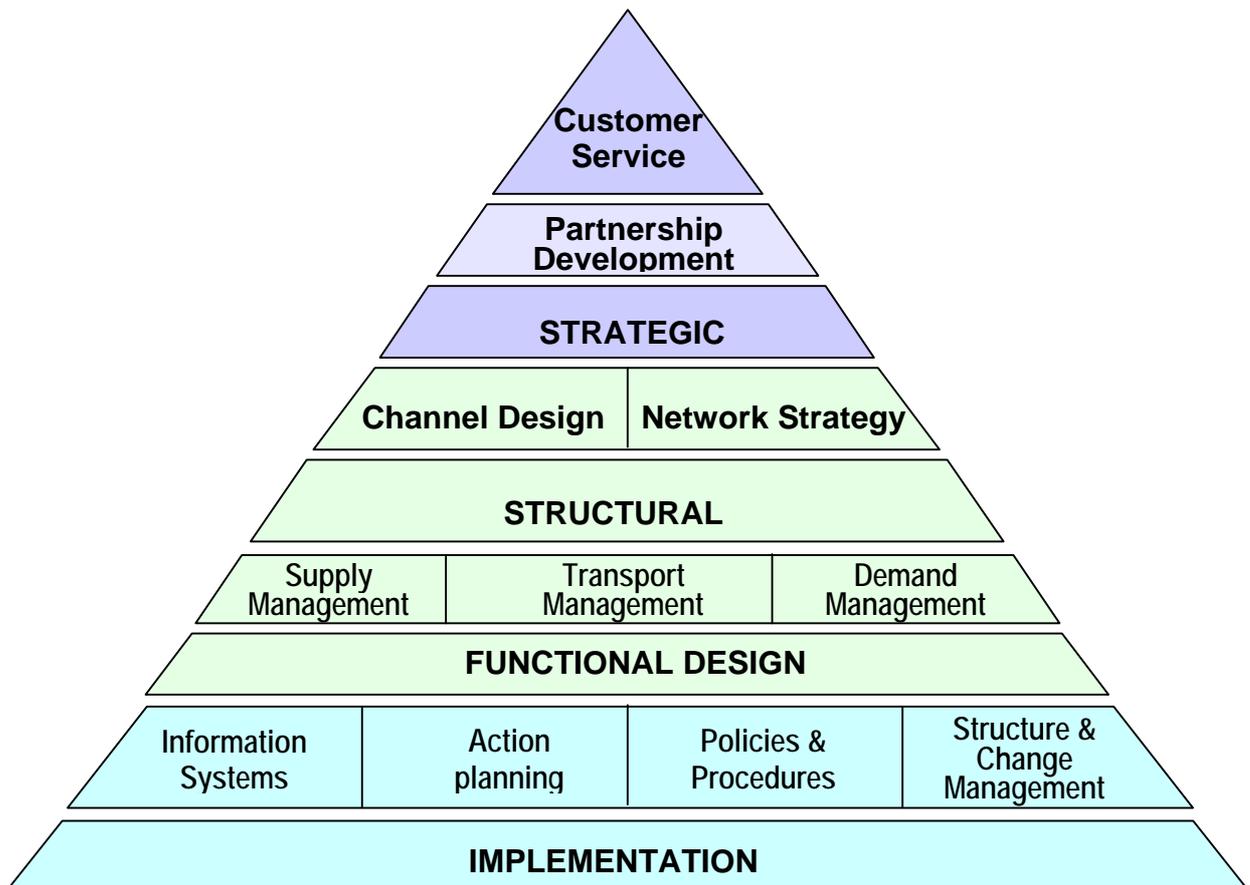
Third-party logistics have recently gained popularity as a broad-based contemporary issue. Recent demand of market forces are causing considerable attention to be focused on logistical functions and revitalising interest in outsourcing them. The need to efficiently and economically adjust logistics support to meet rapidly changing market demands is growing significantly. Outsourcing to third parties has become a strategic issue demanding greater attention in corporate boardrooms of small, medium and large organisations that want to remain competitive and cost-effective in the future.

According to Robeson *et al* (1994: 835), the term ‘third-party logistics’ first became widely used in the mid- to late 1980’s as a descriptor for the outsourcing or sub-contracting of elements of the logistics process, and further states that ‘leading edge firms have a greater tendency to manage logistics as a value-added process, reflect a stronger commitment to achieving and maintaining customer satisfaction and place a premium on flexibility.’ Refer to figure 4.1 on the following page for a popular schematic breakdown of the logistical process. A common profile of these leading-edge companies that implement integrated logistics management include the following three main characteristics:

- (a) Leading-edge organisations seek to use logistical competency to gain and maintain competitive superiority.
- (b) These companies seek to add value to the products and services they market, supporting this goal by operating a cost-effective logistical system.

- (c) They leverage their assets by forming strategic alliances with service suppliers. These alliances help the companies achieve preferred-supplier status with key customers.

Figure 4.1 Approach to managing logistics



- Sources:**
- Franz, Cilliers, & Andrews. 1994. *Logistics excellence in South Africa*.
 - Robeson and Copacino. 1994. *The Logistics Handbook*.

Companies primarily concerned with exploiting their market opportunities through customer satisfaction, often work with these specialists and third-party suppliers to ensure the ultimate competence in meeting customer demands. It is interesting to note that many companies that outsource their non-core business activities, chose to either identify single-source suppliers for particular disciplines within logistics or, at the very

least, use only limited sources. In this way, administration of the process is simplified and economies of scale become possible by concentrating the viable business on a limited number of resources. These logistics alliances are by nature ‘win-win’ endeavours creating greater efficiencies for the system as a whole.

Through personal interviews with managers at various record companies and SCM companies (refer to the sources of knowledge in Chapter 5 under point 5.4.3.2), it was revealed that these managers believe that the organisation of the future will be ‘knowledge-based and information-based’. With the increased emphasis on down-sizing or right-sizing leading to the outsourcing of many labour-intensive functions, many authors and academics believe that third-party logistical activities will increasingly grow.

4.2.4 Outsourcing integration driven by management

Mechanical principles dictate that any chain is only as strong as its weakest link. Many supply chain participants are still focused mainly on products and markets (and other static elements), meanwhile neglecting aggressive management of the supply chain itself as a strategic source of added value. In many cases, significant value is being overlooked or simply not being captured. Others are limiting their integration efforts to quick, tactical solutions, rather than launching more far-reaching strategic initiatives. Also refer to the discussion on static and strategic strategy components discussed in Chapter 1 under point 1.4.3.

Supply chain management (SCM) is one of the latest buzzword in many industries around the world and is said to be saving these industries millions of rands. Through primary research (refer to the Primary sources of knowledge under point 5.4.3.2. and to the Questionnaire in Annexure I on page 198), it has become clear that the local South African recording industry has not yet entered into the world of outsourcing – most local record companies still keep all or most of their business processes tightly in-house.

4.2.4.1 Management capabilities

A company cannot manage its way in or out of a changing environment, but needs to lead it through innovations and the development of new technologies. However, Behrmann (2000: 1 – 2) offers a note of caution to companies that wish to implement tools which will help them in managing discontinuous change: a sure recipe for failure is hiring only IT (Information Technology) specialists to facilitate the adaptation. The process must be business-driven and not technology-driven. Technology on its own does not create wealth or growth or a new mindset, but rather the intelligent use of technology applied to business objectives. Business leadership must thus drive the process and only then allow the technologists to get on with the job of making it work.

According to Useem, professor in Management at the University of Pennsylvania (in Kunz 2000b: 1 – 2), the new outsource manager will require at least four important capabilities:

(a) Strategic thinking

He will need to think strategically in order to determine what to outsource and how to add competitive advantage to the business through the outsource deal. As outsourcing develops and changes, both the customer and the supplier or service provider's management will need the skills to facilitate new trends such as risk and reward programmes, contract interpretation and implementation as well as the constant strategic realignment of the service and the contract.

(b) Negotiating skills

The outsource manager must possess the ability to continually negotiate the right deal for the company while ensuring that the deal is in line with internal requirements. The management team needs the necessary experience, leadership skills and theoretical exposure to outsourcing in order to be aware of internal needs and requirements as well as external opportunities and availabilities.

(c) Partnership governing

This management capability is essential to ensure that the outsourcing deal works for both the outsourcer and his partners. These days, leading companies are outsourcing for strategic reasons and not simply as a 'quick fix'. This means that the customer's management must be fully informed and the supplier's strategy understood. On the other hand, the supplier's management structure must in turn understand the customer's strategy in order to be able to interpret it correctly. This will cause both the management teams of the partners in the relationship to work together towards achieving the same goals and objectives.

(d) Change management skills

Management will need change management skills not only to counter employee resistance but also to continuously align and re-align the outsource transaction to the business requirements (refer to the discussion on managing business change in Chapter 1 under point 1.3). Initially, business paradigms may have to be changed to allow the acceptance of the outsourcing agreement by management and employees alike.

4.2.4.2 Key success factors

The reality of corporate management challenges is thus what should be driving supply chain and outsourcing trends in the recording industry (Kemp 2000: 1 – 2) and this bodes well for SCM and other logistics service providers. The caveat is that the sourcing company must find service providers who clearly understand their role and are strong enough to meet all demands. Much has been documented recently about the opportunity of new supply chain execution technologies to provide noticeable cost- and time-savings. Most of these technologies are targeted at reducing the cost of transactions and / or improving the visibility of supply chain transactions and costs. Inventory Carrying Cost (ICC) is the most obvious tangible goal of a project. (ICC is defined as cost of capital plus variable costs such as shrinkage, damage and obsolescence.) On the other hand, there exists less tangible, but far more strategic project objectives, of which the influence can be just as great. A good example of an

intangible goal is service level improvement, in the form of maintaining gross profit by improving customer loyalty. The problem at hand is that it is very difficult to separate the strategic from the tactical (or static) in supply chain optimisation. Many experts believe that failed projects often have their root cause in management's inability to dynamically link strategy and execution (Buys 2000a: 1 – 3).

Below are listed five important key factors which should receive attention in the management of the outsource relationship:

(a) Due diligence

Time must be taken to ensure due diligence is performed between the parties. This must include open and honest declarations regarding expectations, goals, targets, costs and service parameters.

(b) Matched needs and capabilities

The outsourcing record company and its chosen supplier or service provider must ensure that their needs and capabilities are matched. Suppliers of goods and services vary widely in their competencies. Care must be taken that the service offering fits the requirements.

(c) Risk determination

Risks need to be determined early on. Some service providers will procure and warehouse their clients' components at their own risk. This means that, according to the outsource agreement, they will ensure that sufficient quantities of their clients' stock are available at all times. In order to maintain safety stock levels, they will manufacture or procure components even before an order is placed. Especially with the high rate of obsolescence in the recording industry, this can lead to a situation where large amounts of capital will have to be written-off when music albums become unpopular, outdated and un-sellable.

(d) Control measures

Some measure of control needs to be maintained, especially if the service provider is not manufacturing all components in-house, but is in turn employing additional sub-contractors to fulfil the outsourcing company's orders (*e.g.* outsourcing the CD manufacture to specialists like *Sonopress* or *Compact Disc Warehouse* – as discussed in Chapter 3 under point 3.2.3).

(e) Confidentiality

Confidentiality must be a prerequisite to the signing of any outsourcing agreement. Companies operating as supply chain or logistic managers in the recording industry will have clients that are competitors (the different record companies). The intellectual property of each need to be guarded and protected unconditionally.

The concept of SCM should thus extend an organisation's value chain forward to its clients' clients as well as backwards to its suppliers' suppliers (Theron 2000: 1). By linking to these value chains and planning in conjunction and within the context of the supply chain, inventories and work in progress can be driven down, lead times can be optimised and the entire supply chain can be made more responsive to changes in demand or supply. As mentioned before, any chain can only be as strong as its weakest link. If the operations of one or more companies in the chain are not executed properly, it will negatively influence the entire supply chain. The onus therefore lies with management to ensure that the chain has no weak links. Managers need to execute the optimised supply chain plan, manage deviations and make decisions in real time. A goal of companies operating in supply chains, must be to achieve negative working capital (*i.e.* sell and get paid before you pay), together with adhering to service levels that exceed customer expectations.

4.3 Integrated supply chain management

4.3.1 Collaborating the supply chain

Collaboration in the supply chain and seamless integration between the various functions and processes are prerequisites for success. Certain inefficiencies were discovered in the management of the supply chains of the local recording industry. These four problems will be discussed below, where after certain success factors that should be implemented in the channel will be documented.

4.3.1.1 Present channel inefficiencies

Before examining the best ways in which to manage a company's integrated supply chain, it is advisable to first be aware of the problems that currently characterise the channel. Through primary as well as extensive secondary research of the local recording industry's current channel, four major problems or inefficiencies were discovered:

(a) **Unpredictable demand**

The signing, recording and marketing of titles in the music industry is a very risky business. It is nearly impossible to accurately forecast the demand for any title or future release. Demand for a title can pick-up, slow down or completely stop without any apparent reason. This puts a great amount of stress on all the participants in the channel, from the initial supplier or manufacturer, right through to the record company, its supply chain management partners and the music trade.

(b) **Poor integration**

Unlike industries such as food service, automobiles and apparel, the local recording industry has not implemented any significant integration in its supply chain. Inefficiencies are emerging that are preventing potential channel growth. Supply chain inefficiencies in particular, have led to chronically delayed new

products, demand distortions, scarcity and allocation problems, inventory obsolescence risks and unpredictable service levels.

(c) Insufficient channel relationships

With the constant pace of change in the end-user's music tastes, participants in the recording industry are under increasing pressure to identify and exploit new value sources and then add this value to the channel. Relationships among supply chain participants are currently insufficient to provide the necessary solutions to many of the problems relating to the integration mentioned above.

(d) Technological growth

The pressures and tension amongst recording industry supply chain participants stem from several sources, some of them by-products of rapid growth that is being fuelled by the current advances in technology. Moreover, consumers are increasingly demanding hi-tech products with better sound and visual quality. Competitors have become increasingly able to emulate one another within ever-shorter time frames. The result of these trends has been a decline in average selling prices and profit margins.

4.3.1.2 Possible success factors

In order to deal with technological, commercial and even social change, organisations are being forced to rethink their current business development strategies. Radical adjustments in focus, positioning, product or service development and relational links with trading partners are required to keep the business on course and meet the ever-greater demands of customers. Hughes, Ralf and Michels (1999: 210) have identified a number of critical success factors that will all, to a greater or lesser extent, influence the way in which companies eliminate present channel inefficiencies:

(a) Top management involvement

Top management needs to give direction and be actively involved in orchestrating the overall change program. As discussed above, it is management

that needs to strategically drive the move towards outsourcing and supply chain management.

(b) Setting goals and strategies

Management needs to develop strategic purpose by setting explicit goals and priorities across all business activities, as well as in dealings with suppliers across the supply chain. An appropriate strategy needs to be determined that will balance the need for business development led by change, together with narrower operational process design.

(c) Critical success areas

It is necessary to define mission critical areas such as market management, redesign of supply chains, supplier responsiveness, product development and strategic target costing. Cross-functional and cross-supply chain integration of effort and expertise is then necessary to address these various target areas.

(d) Segmentation

The various supply chains and supply processes must be segmented (for better understanding, delegation and management) and then resources must be allocated accordingly.

(e) Continuous change management

The required change management capabilities, such as project management and process measurement, must be strengthened in order for change to occur. This is especially important in companies with deeply ingrained traditional paradigms.

Extensive attention and activity related to improving supply chain integration is becoming a top management priority. The international market seems to have realised the immense value that can be added to their own internal business operations by being an active channel member and working closely together with partners, suppliers and outsourced service providers.

4.3.2 Supply chain integration

Synchronised supply chain planning is no longer a future promise – it is a reality, if not a prerequisite, for competitive performance (Hunter 2000: 1). Rapid technological change, ever-shorter product life cycles and increased supply chain complexity in the recording industry have all compounded the challenge of matching supply to demand. The industry's changing supply chain structure has created further challenges for supply chain value enrichment. A critically under-utilised key to lean inventories and increased market agility is the degree to which supply chain partners collaborate in planning and executing the combination of tasks that bring a product from raw materials to market.

In practical terms, even though music albums often have short lifecycles, these products tend to have similar lifecycle trends over the period from introduction and adoption, to tail-end sales and ultimately very low sales after the announcement of a follow-up album (Buys 2000a: 2 – 3). New albums often tend to replace prior titles and in essence are sold or upgraded into the same customer base as the superseding title. This lifecycle inheritance implies invaluable corporate experience and knowledge: it guarantees a measure of consistency, which massively reduces the workload of product managers when new products are introduced into the market.

Linkages among the participants in a company's supply chain are a key dimension of the organisation's overall supply chain strategy. The foundation of a supply chain integration strategy can be formed by answering questions relating to the degree to which the company should integrate across its supply chain, as well as looking at the alternative types of supply chain integration that are required. Gattorna (1999: 28 – 32) calculated that supply chain integration can fundamentally be divided into four different forms – information, decision, financial and operational integration:

(a) Information integration

Information integration enables companies across the supply chain to share useful information. It is vitally important that companies working together in a chain are aware of what the other are doing regarding any new developments,

technologies, innovations, marketing campaigns or any other issues that might influence the relationship between the parties, as well as with their external relationships with the market.

(b) Decision integration

Decision integration supports the planning and control functions of management across multiple organisations within the supply chain. Once again, this confirms the need for working together and being transparent in the relationship. Continuous communication will be necessary to achieve decision integration in the channel.

(c) Financial integration

Financial integration changes the terms and conditions of payment across the supply chain. A manufacturer may agree to warehouse goods for a specified period of time and then only demand payment from its client when the goods are actually delivered to the reseller. Some manufacturers only demand payment at the time its products are sold by the market (the wholesalers, dealers or retailer), rather than demand payment at the time the goods are sold into the market.

(d) Operational integration

Operational integration encompasses the sharing of physical and human assets between participants within a supply chain. A SCM company may provide warehouse space to one or more of its suppliers for the purpose of producing components for the assembly line. Beyond the savings in the fixed costs of warehouse space and equipment, such arrangements enable both parties to respond more quickly to production changes and to reduce overall cycle times and costs.

4.4 Outsourcing pitfalls

Through primary literary research (refer to the list of References at the end on the thesis) and by consulting, examining and quantifying primary sources of information

(refer to the Primary sources of knowledge under point 5.4.3.2. and to the Questionnaire in Annexure I), it was revealed that all outsourcing agreements are not necessarily successful. In these cases, it seems that there is no one single aspect of an outsourcing relationship that can be blamed - outsourcing is a complex business management relationship, which was usually uniquely constructed to satisfy a set of specific circumstances.

An unprepared company can easily fall into the various pitfalls that exist in the outsourcing process and the subsequent management thereof. These pitfalls are grouped under the headings of business, people and technology:

(a) Business-related pitfalls

As has been thoroughly proven throughout this thesis (refer to Chapter 1, point 1.3.1), business is in a constant state of change. When a business is considering outsourcing some of its business processes to a third-party SCM partner, the following business-related possibilities and their effect on the relationship need to be considered:

- A downturn in business or a decrease in business volumes may mean that the outsourcing contract must also decline
- A possible change in the line of business will have to be incorporated into the outsourcing agreement
- Changes in the business direction may mean that a record company has an expensive outsourcing contract for services it may no longer need
- The outsourcing agreement must take the possibility of acquisitions, mergers and de-mergers into account and must be open to re-negotiations
- One of the major and most common business-related pitfalls is choosing the wrong supplier. Pre-qualification of suppliers is extremely important – for long term contracts a record company should choose suppliers that are large and stable. When looking for lower costs, suppliers with economies of scale and many similar customers should be selected

One way of improving the chances of implementing a successful outsourcing agreement, is to draw up service level agreements (SLA's) between the two parties. Refer to Annexure F at the end of the thesis where some of the main elements of a SLA are listed. It is important to note that a SLA is not a sure recipe for success and may fail for various reasons, most important being a lack of commitment with regards to issues such as resources, finance, monitoring tools, support tools, management, control and direction.

(b) People-related pitfalls

The following seven important people-issues need to be addressed before a company embarks on an outsourcing project:

- Assessment of the skills inventory (aspects such as what the company currently has, what it should keep and not keep and what the right size is). These are questions which may be answered by utilising the benchmarking tool which was discussed in Chapter 1 under point 1.4.4
- Any people- or employee-related legislation or other government rules and regulations need to be taken into account
- Outsourcing negotiations can rarely be kept quiet. Since there will always be concerns about job security, the record company should inform their staff about what is happening and help the effected people deal with the changes
- The people considerations should also begin at the start of the discussions about outsourcing, which means early liaison between the human resources departments. Assessments of core competencies and skills, company philosophies, cultures and values, human resource practises and all other policies and procedures should be carried out and diligently monitored
- In the beginning, the changes in relationships between people from both sides may not be easily accepted, therefore these changes should be dealt with accordingly and managed properly

- Outsourcing is about delivering a service and irrespective of what it states in the SLA, the final arbiters of whether the service is good, bad or indifferent are the users. They are the ones who will make it work or fail and it is therefore important that they are satisfied with all or at least most aspects of the agreement
- People who are forced to work together as a result of the new outsourcing contract may experience initial difficulties. The importance of a working relationship between the parties is essential to the stability of the outsourcing contract

(c) Technology-related pitfalls

Worldwide, companies are evolving to give more power to lower management levels, more local autonomy and more accountability. These trends together with emerging technologies, will make users weigh what they are having to pay for an outsourcing deal, against what might be achieved by using their own internal technologies. The result of a poor technological decision could be that the centrally provided function becomes inefficient and the customer (the record company) pays both for a centralised service from the outsource supplier, as well as for allowing the company's own internal users to expand their own internal technology. While an IT company will not outsource its technology development function (*i.e.* a core competency and possible main reason for existence), a record company can certainly outsource its smaller technological needs to an outside service provider.

Two possible technology-related pitfalls to look out for are:

- Different factors will affect the cost profile of an outsource contract during its life. Those that are purely people intensive will have a cost profile that rises with inflation and pay settlements and in turn falls with the improved productivity of those people. IT outsourcing contracts are technology sensitive. The cost of IT is coming down and contracts must

ensure that both the record company and the outsource supplier share the cost benefits that accrue from exploiting cheaper technologies

- IT is a critical function to a record company. The management information system (MIS) manages its inventory and generates stock, sales and other crucial reports (refer to the functions of a MIS discussed in Chapter 3 under point 3.2.2). The record company must ensure that this business process continues to receive the critical attention it requires from the outsource supplier.

4.5 Summary

If a business' supply chain is optimised through efficient management, it follows that the needs of customers will be successfully met. This success is, however, due as much to the supply chain as it is to the business itself. According to the Sales Director of a major Information Services company (in Edwards 1999: 1 – 2), the degree to which decision-makers buy into the process of collaboration in the supply chain will determine the holistic success of supply chains in the new global economy.

The Operations and Marketing Director of a South African logistics company operating in various IT, software and music supply chain management industries, states that SCM will achieve substantial growth by offering cutting-edge technology and world-class service (Thornhill in Gillingham 2000: 17). Clients of channel management companies are demanding solutions that will add value to their businesses. This can be achieved through a combination of cost-effective and efficient integrated management solutions that are geared to meeting all global operational and logistical requirements. In Chapter 5, by testing the hypothesis statement, the processes of a completely outsourced supply chain of a South African record company are researched and evaluated (MODEL B). The tested model is discussed in Chapter 6 as MODEL C.

CHAPTER 5**RESEARCH METHODOLOGY**

5.1	Introduction	106
5.2	The business strategy framework	107
5.2.1	Competitive and corporate strategy	108
5.2.2	Strategic decisions	109
5.3	Properties of the research	110
5.3.1	Rational and empirical thinking	110
5.3.2	Different thinking styles	112
5.3.3	Hypotheses	114
5.3.3.1	The role of a hypothesis	114
5.3.3.2	The hypothesis statement	114
5.4	The research methodology	115
5.4.1	Identifying the topic to be researched	115
5.4.2	Exploration and judgement of the situation	116
5.4.3	Designing the research study	116
5.4.3.1	Information sources	117
5.4.3.2	Primary sources of knowledge	118
5.4.4	Sampling and data capturing	121
5.4.4.1	Major players	121
5.4.4.2	Measurement scales	121
5.4.5	Evaluation and interpretation of the researched information	123
5.4.6	Writing the thesis	123
5.5	Summary	124

5 RESEARCH METHODOLOGY

5.1 Introduction

Research is the systematic, controlled and critical investigation of events, led by theories and hypotheses about these events. Business research - as was conducted throughout this study - can in turn be defined as a systematic investigation in order to provide information that may or may not be used to solve business problems. A business problem and hypothesis was stated in Chapter 1, which led the study from A (the current situation), through B (the hypothesis statement), to eventually reach C (the tested model). Refer to Figure 1.2 on page 5 for a schematic diagram of the three models as well as to Figure 6.1 which contains a diagram of the outsourced MODEL C.

The five main attributes of a proper business research process were followed throughout this study. These characteristics or attributes, which should follow each other chronologically, are:

(a) Description of the research objective

The objective of the research was documented in Chapter 1 under point 1.1.3, which in short is examining the current supply chain of the South African recording industry (described as MODEL A), stating and researching the hypothesis (MODEL B) and then describing the tested outsourced supply chain management or functional logistics model for this industry (MODEL C).

(b) Explanation of the research procedures

The research procedures are explained later on in this chapter under the research methodology discussion (refer to points 5.4.1 to 5.4.6 below).

(c) Illustration of the planning of the research

Planning took place throughout the entire research process, as well as before and during the writing of the thesis. This planning was performed and executed in

accordance with the elements and thought-processes of proper research methodology principles.

(d) Analyses of all data

All gathered data (*i.e.* both primary and secondary data) was analysed in order to determine its relevance, validity and importance to this study. These sources of knowledge are discussed under point 5.4.3.2 below.

(e) Submission of conclusions and recommendations

Conclusions and recommendations were limited to the parameters of the hypothesis statement, as well as to the data that were gathered during the research process. The information that was incorporated into this study was justified by this research. The conclusions that were consequently reached, as well as the recommendations resulting from the study of the hypothesis statement (MODEL B), are summarised in the last chapter.

5.2 The business strategy framework

While evaluating the current supply chain in the South African recording industry (MODEL A), researching the hypothesis statement (MODEL B) and then documenting the outsourced model (MODEL C), the principles of a sound business strategy and its framework were always kept in sight. According to Mathur and Kenyon (1998: 1), business strategy consists of the following two elements:

- *Competitive* strategy which positions a single competitive offering in relation to customers and competing substitutes
- *Corporate* strategy which manages a company's cluster of offerings, by deciding what offerings to add, retain, divest or outsource

5.2.1 Competitive and corporate strategy

Both a company's competitive and corporate strategies have a financial goal, which in short is making the company more valuable to its owners or shareholders in the long term. This is true of the smallest one-person independent record company as well as of the big international Majors (refer to the discussion on the players in the recording industry in Chapter 2). If the business does not at least earn its cost of capital, it can not survive independently.

Competitive strategy tends to pick profitable or value-building offerings. An offering in turn builds value, *i.e.* earns more than its cost of capital, if it simultaneously exploits:

- A favourable market opportunity, by addressing a set of customers (in this case the dealers and retailers in the trade, as well as the end-users) which are willing to pay prices at which the offering can meet the financial objective
- The company's own distinctive resources which give it an edge over competitors (for example the record company's contracts with their artists)

These two conditions are like the blades of a pair of scissors, which can only cut when used or implemented together. Favourable market opportunities arise from the way an offering (*e.g.* a new album release) is positioned, which is done either:

- By differentiating the offering, *i.e.* distancing it from competing substitutes (for example through extensive marketing campaigns) in order to make customers willing to pay value-building prices
- By competing on price, with a low degree of differentiation and a very competitive unit cost (refer to the *MFP* model of being a loss-leader discussed in Chapter 3 under point 3.4)

While again referring to the two different strategies (competitive and corporate) discussed above, the need for sustained value-building can be met in two different ways:

- In *competitive* strategy, by developing distinctive resources which are specific to the record company
- In *corporate* strategy, by successfully picking winning artists and recording successful albums, and then by employing skill and judgement in timing these additions to the catalogue (*i.e.* deciding when and how to release these albums into the trade)

It is important to remember that only *developing* these value-building strategies are no sure recipes for success. Gathering the correct information, making good decisions and then implementing those decisions are the three basic steps in strategic decision making (McNeilly 2002: 29 – 33). As with any plan, the execution thereof remains one of the most critical aspects of its success. Sterling (2003: 27) claims that the effective implementation of an average strategy beats the mediocre implementation of a great strategy.

5.2.2 Strategic decisions

Business executives have to take decisions and make a multiple of choices every day. Interviews with top management executives at record companies (refer to the list of respondents in point 5.4.3.2), concurred with the findings of Rumelt, Schendel and Teece (1991: 15), who stated that these strategic choices include, amongst others, the following six major aspects:

- The primary goals of the company
- Which products and services to offer to the market (*i.e.* which artists to contract and / or which labels to distribute)
- Policies for positioning the company in different product markets
- The level of scope and diversity (*e.g.* possible backward and forward integration and outsourcing)
- Organisation structure
- Administrative systems used to define and coordinate work (*i.e.* the management information system or MIS as described in Chapter 3 under point 3.2.2)

The research of this study was conducted with these six concepts kept in mind. Whether a company performs all functions in-house, or whether it makes a strategic decision to outsource some of its non-core business activities to a third party supply chain management partner, might be one of the strategic decisions that will eventually determine the success or failure of the business.

5.3 Properties of the research

5.3.1 Rational and empirical thinking

Theoretical as well as empirical research were performed throughout this study. Rational thinking played an important role in the evaluation of information as well as in the conclusions and recommendations that were reached and are discussed at the end of the thesis. Both rational and empirical thinking are defined and discussed below:

(a) **Rational thinking**

Rationalism implies that reason must be the primary source of knowledge. All information must be derived from rules, laws and basic truths. This is also called deductive thinking, which is the deriving of a conclusion by reasoning – in other words the conclusion is reached by logical deduction.

It thus follows that the conclusion must be derived directly from the gathered information and its reasons and explanations. The reasons must implicate this conclusion and represent a proof. There is a very strong relationship (or connection) between this information and reasons, and the ultimate conclusion that is reached. A deduction can only be valid if it is impossible for the conclusion to be untrue if the assumptions are true. For example:

Assumption 1: The Recording Industry of South Africa (RISA) awarded all *Sony Music* artists with a special South African Music Award.

Assumption 2: Robert Smith is a *Sony Music* artist.

Conclusion: Robert Smith has been awarded with a special South African Music Award by RISA.

Another example of rational thinking could be seen in the deductions that were made after studying the sales figures on the RISA website (www.risa.co.za). Refer to Table 2.4 where the sales figures were documented. In the year 2000, 139 137 485 units of local music were sold, in 2001, 156 806 304 units were sold, in 2002, 192 165 934 units were sold and in 2003 a record amount of 225 090 965 were sold. This information leads to the true conclusion that the sales of local music in South Africa has increased over the four year period from 2000 to 2003.

(b) Empirical thinking

On the other hand, empiricism implies that the observations were mainly obtained through experiences in the business environment. Events are described, explained and predicted by means of observation and experience – this process is also called inductive thinking.

With induction, there is not such a strong connection between the information and its reasons, and the conclusions derived from this information. A conclusion is derived from one or more facts or sets of facts. The conclusion then explains this fact or facts while the facts in turn explain the conclusion. It is very important to note that this conclusion is only a hypothesis, in other words only one explanation and there may be many other true hypotheses (*i.e.* assumptions or concessions made for the sake of argument), that can be derived from the same fact or set of facts. Refer to the discussion on the role of a hypothesis in point 5.3.3 below.

Empirical thinking was sometimes used to evaluate the information received as answers to the open-ended questions from the respondents who were interviewed personally or telephonically.

5.3.2 Different thinking styles

No two persons or two companies are alike. Each are governed by its mindset and ingrained paradigms (refer to the discussion on paradigms and their various business influences in Chapter 1 under point 1.3.2). People act differently, work differently, think differently and gather their information in different ways. Some different thinking styles (also known as sources of knowledge) are:

(a) Untested opinions

These are generally believed by most people, even though the opposite may have been proven true. Many record companies in the recording industry continue to believe that outsourcing will ruin their business, because they will lose control of many of their business processes. This paradigm unfortunately remains a strong opinion. By testing MODEL B, the hypothesis statement: “Record companies in the South African Recording Industry should outsource all their non-core business activities to one strategic business partner” – the aim of this thesis is to prove the above-mentioned untested opinion wrong and offer an alternative of remotely managing the supply chain by outsourcing all non-core business activities (MODEL C).

(b) Self-evident truths

These basic truths are derived from the laws of nature, for example ‘The Law of Gravity’.

(c) Method of authority

People with status or in high corporate positions are often automatically believed because of their social standing or business position. Management’s thinking styles filter down to the entire organisation. If the management team is open to change and willing to change their paradigms, this change in the mindset will likely be followed by the company and its employees as a whole. If a sales manager is for instance excited about a new record release, his or her enthusiasm

should filter through to his or her sales team and they should then also sell and promote this title with enthusiasm.

(d) Literary style

This source of knowledge implies information that has been gathered through the work done by others. This information should be interpreted in terms of its scientific goal and perspective, and not in terms of the abstract and general categories of the researcher's own reference scheme. Refer to the Reference list at the end of the thesis as an example of information gathered and documented by others.

(e) Postulational style

In this thinking style formal, mathematical terms and postulates are studied. A postulate is an essential presupposition, condition or premise of reasoning. This thinking and reasoning will lead to logical information such as mathematical models, simulations and business laws. Postulational thinking can be used successfully to determine the composition of the market before a new product is launched. Postulational thinking is also a good example of *deductive rationalism* (refer to the discussion on rational thinking in point 5.3.1 above).

(f) Scientific method

This thinking style is a combination of logic and rationalism, in other words a form of *inductive empiricism*. It is a direct observation of the phenomena in the market. The thinking is done through very clearly defined variables, methods and procedures. Hypotheses are tested empirically. The thinking has the capacity and ability to eliminate contradictory hypotheses - simply stated it can thus be viewed as a self-correcting process.

This last style discussed (*i.e.* scientific thinking), is the source of knowledge that was most widely used throughout the research processes of this study. Although various literary sources (as per the reference list) were consulted (*i.e.* secondary information), the majority of the research concentrated on the information gathered from the

completed questionnaires, personal interviews and market research (*i.e.* primary sources of information used in a logical and rational way, discussed in point 5.4.3.2 below).

5.3.3 Hypotheses

5.3.3.1 The role of a hypothesis

A good hypothesis has three very distinct qualities. In order to be true, a hypothesis must be adequate, testable and better than its rivals.

Furthermore, a hypothesis must also perform the following four functions:

- Lead the direction of the study and its research
- Limit the data that is to be studied (set the parameters)
- Identify the relevant information
- Provide a framework for the conclusions that will be derived from the research

5.3.3.2 The hypothesis statement

The hypothesis statement is referred to throughout this thesis as MODEL B and reads as follows:

“Record Companies in the South African Recording Industry should outsource all their non-core business activities to one strategic business partner.”

This hypothesis statement adheres to all the requirements of a proper hypothesis statement which was stated in point 5.3.3.1 above:

- It is adequate because it summarises the core content of the thesis in one sentence
- It is testable because the hypothesis (MODEL B) will be tested in the South African Recording Industry and related markets

- It is better than its rivals because it contains all the necessary elements of a proper hypothesis statement
- This hypothesis statement will further more lead the direction of the study
- It limits the data, sets the parameters and identifies the relevant information of what was studied (*i.e.* Record Companies in the South African Recording Industry and the outsourcing of their non-core business activities to a strategic business partner)
- It provides a framework for the conclusions that were derived from the research

5.4 The research methodology

The research in this study was conducted by following these seven basic steps, which are discussed in more detail below (points 5.4.1 to 5.4.6):

1. Identify the topic to be researched
2. Exploration and judgement of the situation
3. Design of the research study
4. Sampling and data capturing
5. Evaluation of the researched information
6. Writing of the thesis
7. Constant analysis, interpretation and corrections

5.4.1 Identifying the topic to be researched

The topic of this study (as was also discussed in Chapter 1 under point 1.1) was reached by analysing the current supply chain of the local recording industry (MODEL A). After various problems and shortcomings were identified, a hypothesis statement was formalised (MODEL B) which was then investigated and tested and ultimately led to MODEL C. The title that was chosen for this thesis reads as follows:

A Supply Chain Model for the South African Recording Industry.

This topic can be split successfully into two meaningfully segments or word phrases:

(a) Supply chain management

A 'total logistics supply chain' as a general term was documented in Chapters 1 and 3. All elements from procurement, warehousing and assembly, through sales, marketing and order processing, up to final distribution, debt collection and reporting were discussed. The concept of outsourcing non-core business activities to a third party business partner was researched and its characteristics, implementations and new possibilities were evaluated and documented in MODEL B. The final tested concept is referred to and discussed as MODEL C.

(b) Recording industry

This industry, and especially its players, processes and performance in the South African market was documented in the second and third chapters.

5.4.2 Exploration and judgement of the situation

After the above-mentioned topic (in point 5.4.1) and hypothesis statement (in point 5.3.3.2) were selected for the study, the overall South African situation was firstly explored. Record companies and supply chain management companies, as well as their suppliers and customers were questioned and interviewed very early on in the research process (refer to the questionnaire which is attached as Annexure I at the end of the thesis, as well as to the sources of knowledge in point 5.4.3.2 below). Where the South African market was lacking in sufficient examples, the international scene was also explored and judged in terms of its validity to be implemented in the current South African situation.

5.4.3 Design of the research study

The format of the research study was designed in accordance with the prescribed methodology of a proper research proposal, by following these four steps:

- (a) Describe the goals of the study in broad terms
The study started off in broad terms with Chapter 1 describing supply chain management and its logistical processes in general.
- (b) Identify and limit the research parameters
By documenting the hypothesis statement (in Chapter 1 under point 1.1.1 and also in point 5.3.3.2 above) the parameters of the study were narrowed to include only certain selected aspects of the South African recording industry, namely the different local players, their business processes and competencies (Chapters 2 and 3). Also refer to the schematic diagram of the three models in Figure 1.2.
- (c) Conduct research
Outsourcing as a business function was researched and documented in Chapter 4. The research methodology is explained in this chapter. Recommendations with regards to the outsourced supply chain management of the non-core activities of a record company are documented in Chapter 6.
- (d) Document conclusions and recommendations
Proving the hypothesis statement (MODEL B) correct, led to the proposal of the outsourced supply chain management or logistics model (MODEL C). Various conclusions, new possibilities for the future, advantages and specific recommendations are made and documented in the final chapter (Chapter 6).

5.4.3.1 Information sources

The following four instruments were used to gather information:

- (a) Secondary sources

The literature sources that were consulted are listed in the References section:

- Textbooks by renowned authors provided the base and framework for the academic component of the research
- Academic journals and trade magazines such as *The Weekly Channel*, provided insight into the more practical aspects of the industry
- On-line information derived from internet sites such as the *ITWeb*, as well as from websites such as www.risa.org, provided insight into current practises, new thinking styles and practical implementations of strategy

(b) Questionnaire

The Questionnaire is attached as Annexure I at the end of the thesis. The Questionnaire was sent to members of RISA (The Recording Industry of South Africa). The RISA membership list is attached as Annexure B and contains the names of 189 member companies. The Questionnaire was sent to 75 of these companies via electronic mail and to another 15 companies via fax. Out of the 90 Questionnaires that was sent out, a total of 37 was returned completed.

(c) Telephone interviews

A total of 22 telephone interviews were conducted with RISA members. In addition to covering issues already discussed in the Questionnaire, these telephone interviews also sought to uncover any potential additional useful information.

(d) Personal interviews

Personal interviews were conducted at management level with eight Record Companies on the RISA membership list. These companies are listed in point 5.4.3.2 below.

5.4.3.2 Primary sources of knowledge

Both primary and secondary information were used in the research process. Company websites and brochures were examined in order to obtain background information on the various companies, their suppliers and clients. Primary information was obtained

mostly via phone calls, e-mails, personal visits and interviews with key personnel. Record companies that were interviewed over a period of time are listed below:

Local South African independent record companies:

- *Fantasia Music*
- *Maroela Musiek*
- *Select Music*
- *Rhythm Records*
- *African Cream*

International record companies ('Majors') with offices in South Africa:

- *Gallo Record Company*
- *Sony Music*
- *BMG Africa*

The following clients and / or suppliers of record companies and supply chain management companies were interviewed:

<u>Company:</u>	<u>Type of business:</u>
- <i>Bowline Fulfilment</i>	Supply chain management company
- <i>Qmuzik</i>	Software company (MIS developer)
- <i>SAP</i>	Software company (MIS developer)
- <i>Compact Disc Technologies</i>	Compact disc manufacturer
- <i>Sonopress</i>	Compact disc manufacturer
- <i>Pick 'n Pay</i>	Music retailer
- <i>Reliable Music</i>	Music wholesaler
- <i>Music Moods</i>	Music dealer
- <i>MFP (Music For Pleasure)</i>	Music merchandiser

The questionnaire that was completed by managers and employees of record companies and supply chain management companies is attached as Annexure I. The Questionnaire was split into three meaningful segments and the following information could be derived from each section:

- Section (a)

This introductory section confirmed the personal profile of the person being interviewed, confirming his / her name, job description, functions and responsibilities within the organisation as well years spent with the company and in his / her current position.

- Section (b)

The aim of the second section was to document the company's profile and nature of business and seeked to place the company into a specific type of industry, for instance a record company, a music dealer or a supply chain management company. Points evaluated included the nature of the business operation, company characteristic and internal company strengths and weaknesses.

- Section (c)

The third section investigated the specific industry in which the company operated. It provided insights into the size of the market, competitive rivalry, the market's growth rate, dominant economic characteristics, driving forces, key success factors as well as external opportunities and treats.

- Section (d)

Although the last section was the shortest and only had three questions, the answers to these open-ended questions provided by far the most valuable information. The questions dealt with the outsourcing of business activities, service level agreements with third parties and the management of all / any outsourcing processes. This section was aimed at gathering information directly

related to the hypothesis statement of MODEL B. It provided insights into the formulation of the outsourced MODEL C.

5.4.4 Sampling and data capturing

The fourth step of the research methodology was the sampling of the database (the players discussed in point 5.4.4.1 below) and the capturing of data (discussed under the measurement scales in point 5.4.4.2 below).

5.4.4.1 Major players

The recording industry in South Africa is dominated by a small number of big players (the so-called 'Majors' or 'Big Five' as discussed in Chapter 2 under point 2.5.2.1). Because of this relative small group of major players in the South African recording industry, three out of the five bigger companies (*i.e.* 60%), as well as five of the smaller independent record companies were interviewed. A total of 37 completed questionnaires were returned by other respondents from the RISA membership list (refer to point 5.4.3 above).

5.4.4.2 Measurement scales

The concepts which were used during the research process and which were then incorporated into the thesis, can be classified as either objects or as properties:

- *Objects* include the things of ordinary experience, such as companies and their employees. Objects may also include things that are not as concrete, for example employee attitudes, management cultures and company paradigms
- *Properties*, on the other hand, are the characteristics of these objects. These may include things like an employee or manager's physical and psychological characteristics. It may also include his / her social properties such as leadership ability and class affiliation or status

Both objects and properties derived from the interviews, telephone calls and completed questionnaires, were treated as data which were measured (refer to the measurement scales below) and interpreted (refer to point 5.4.5 below).

Much of the gathered data (whether relating to objects or to their properties) were encoded to make it easier for the information to be analysed and compared. Depending on its nature, the data were grouped into one of the four main scale-types:

(a) Nominal scale

This measurement scale is the least powerful of the four scale types. It has no order, distance or origin and its basic empirical operation is to determine equality. The data set is partitioned into subsets or categories that are mutually exclusive and collectively exhaustive. Even though some purists argue that the use of a nominal scale does not qualify as measurement, it is the scale that is most widely used in business research.

(b) Ordinal scale

This scale has order but no distance or unique origin. It is used in the determination of greater or lesser values. It implies that one statement is 'greater than' or 'lesser than' or even 'equal to' another statement, without stating how much greater or less.

(c) Interval scale

The interval scale has the powers of nominal and ordinal scales (order and distance), plus one additional strength in that it incorporates the concept of equality of interval (in other words the distance between 1 and 2 should equal the distance between 2 and 3). Still, the interval scale has no unique origin and can be used only in the determination of equality of intervals.

(d) Ratio scale

This scale possesses order, distance as well as a unique origin. Its empirical operation is the determination of equality of ratios.

5.4.5 Evaluation and interpretation of the researched information

This was the fifth and final step of the research methodology. The sources of knowledge were documented earlier in point 5.4.3.2, but below is a short summary of the three main groupings of the gathered information.

The data that were used in the writing of this thesis, was obtained in one of the following three ways:

- (a) Primary data were collected for the purpose of evaluating the most relevant information pertaining to the topic of this thesis.
- (b) Secondary data, which is data that already exists, were obtained by consulting various literary sources in order to collaborate the most accurate, current and widely accepted market trends.
- (c) Interviews were conducted with managers and lower-level employees at some of the biggest record companies and supply chain management companies in the country, as well as with their main suppliers and clients. The interviews were designed with the specific purpose of obtaining hands-on information relevant to the current local and global trends in the recording industry (the questionnaire is attached as Annexure I).

All gathered data were scrutinised and then reduced to a manageable quantity. It was then used to develop summaries, look for patterns and apply statistical techniques. None of the data were ignored. It was either categorised as irrelevant, or as relevant, current and topical in which case it was used as information.

5.4.6 Writing the thesis

Finally, by incorporating all primary and secondary research, the thesis was written in a systematic and controlled way. The gathered research and all other relevant market

experiences that were obtained were incorporated into the study. The outsourced MODEL C is discussed together with all findings, conclusions and recommendations in the last chapter.

5.5 Summary

As documented in the introduction to this chapter, research can be defined as the investigation of events as well as the theories and hypotheses relating to these events. When the topic of this thesis was selected, the research of relevant events, market trends and relevant business processes in the South African recording industry were undertaken in a systematic, controlled and critical manner. In order to ensure that all relevant data were given an equal chance to be incorporated into the end-results, different thinking styles were used as sources of knowledge. The research methodology was documented in points 5.4.1 to 5.4.6 above.

In the previous chapter, research conducted into the processes of outsourcing non-core business activities to a third-party business partner, as well as the concept of integrated supply chain management were discussed and evaluated (refer to points 4.2 and 4.3). This information, in combination with the conclusions already reached in earlier chapters, led to the results which are incorporated into the sixth and last chapter as MODEL C (i.e. the Conclusions of the study). Recommendations for the future of supply chain management companies in the recording industry are also evaluated and discussed.

CHAPTER 6

RESULTS, CONCLUSIONS AND RECOMMENDATIONS: THE PROPOSED OUTSOURCED SUPPLY CHAIN (MODLE C)

6.1	Introduction	127
6.2	Contracting the artist	130
6.3	Manufacturing	130
6.3.1	Procuring components from strategic partners	130
6.3.2	Lead times	132
6.3.3	Costs of holding inventory	133
6.3.4	Benefits of holding inventory	135
6.3.5	A re-ordering model	137
6.3.5.1	Determining the re-ordering criteria	137
6.3.5.2	Calculating the quantitative value	139
6.3.5.3	The re-ordering formula	140
6.4	Warehousing	142
6.4.1	Distribution Resource Planning	142
6.4.2	Quality control and protection of intellectual property	143
6.4.3	Pro-active warehouse management	143
6.4.4	Designing a functional warehouse	145
6.4.4.1	Preliminary planning steps	145
6.4.4.2	Physical lay-out	147
6.4.4.3	Vertical space	148
6.4.5	Outsourced warehousing	149
6.4.6	Geographic location	151
6.4.6.1	Factors influencing location	151
6.4.6.2	Factors influencing delivery lead-time	153

6.5	Marketing	155
6.5.1	The business plan	155
6.5.2	The four marketing questions	156
6.5.3	The marketing plan	157
6.6	Sales	160
6.6.1	Selling skills	160
6.6.2	Types of buyers	161
6.6.3	Sales management formula	164
6.7	Inventory management	166
6.7.1	The Management Information System	166
6.7.1.1	MIS functions	167
6.7.1.2	MIS development	168
6.7.1.3	MIS advantages	169
6.7.2	SAP supply chain management	171
6.7.3	Order processing	172
6.7.4	Invoicing	172
6.7.5	Shipment reporting	173
6.8	Physical distribution	173
6.8.1	Outsourced distribution	173
6.8.2	Emergency shipments	175
6.8.3	A competitive advantage	176
6.9	Debt collection	177
6.9.1	Management of receivables	177
6.10	Royalty payments	178
6.11	Summary	180

6 CONCLUSIONS AND RECOMMENDATIONS: THE PROPOSED OUTSOURCED SUPPLY CHAIN (MODEL C)

6.1. Introduction

In Chapter 5, the Research Methodology of the thesis was documented. Point 5.4.3.1 listed details of respondents to the questionnaires, telephone calls and personal interviews. After studying all available information, the results of this research process is documented as MODEL C in this chapter.

In this outsourced approach to the management of the South African recording industry's supply chain, a new player is created to be added to the four players currently involved in the market. The current role players, as discussed in MODEL A in Chapter 2 under points 2.3 to 2.7, are:

- (a) Artists or bands
- (b) Record companies
- (c) The trade (*i.e.* music retailers, dealers, wholesalers and other independent music stores)
- (d) Consumers (*i.e.* the end-users or ultimate target market)

After testing the hypotheses statement (MODEL B), a fifth player was added to the mix, namely: the *independent supply chain management company*. Other terminology used for these supply chain managers are logistics managers or transaction managers.

The six processes currently being followed in MODEL A were discussed earlier in Chapter 3 under points 3.2 to 3.7. After testing MODEL B, these logistical processes were changed and responsibilities were re-allocated and adapted in MODEL C. The six current logistical processes of MODEL A (as was discussed in points 3.2 to 3.7), are:

- Manufacturing
- Warehousing and distribution
- Selling
- Marketing
- Debt collection
- Management of receivables

Chapter 2 (*Players* in the chain) and Chapter 3 (*Processes* in the chain) are now integrated and discussed simultaneously as they would be managed in MODEL C.

In short, the chain and the responsible parties of MODEL C are explained by elaborating on the following nine activities:

- | | |
|---------------------------|--|
| - Contracting the artist: | remains the responsibility of the record company |
| - Manufacturing: | ordered by the record company, but logistically controlled and managed by the supply chain management or SCM company |
| - Warehousing: | performed by the SCM company |
| - Marketing: | responsibility of the record company |
| - Selling: | sales function performed by the SCM company |
| - Inventory management: | managed by the SCM company in its warehouses |
| - Physical distribution: | executed by the SCM company |
| - Debt collection: | by the SCM company |
| - Royalty payments: | remains the responsibility of the record company |

Thus, the only four responsibilities that remain with the record company, are contracting artists, deciding on and ordering the manufacturing of its titles from its SCM partner, marketing its titles and paying the necessary royalties.

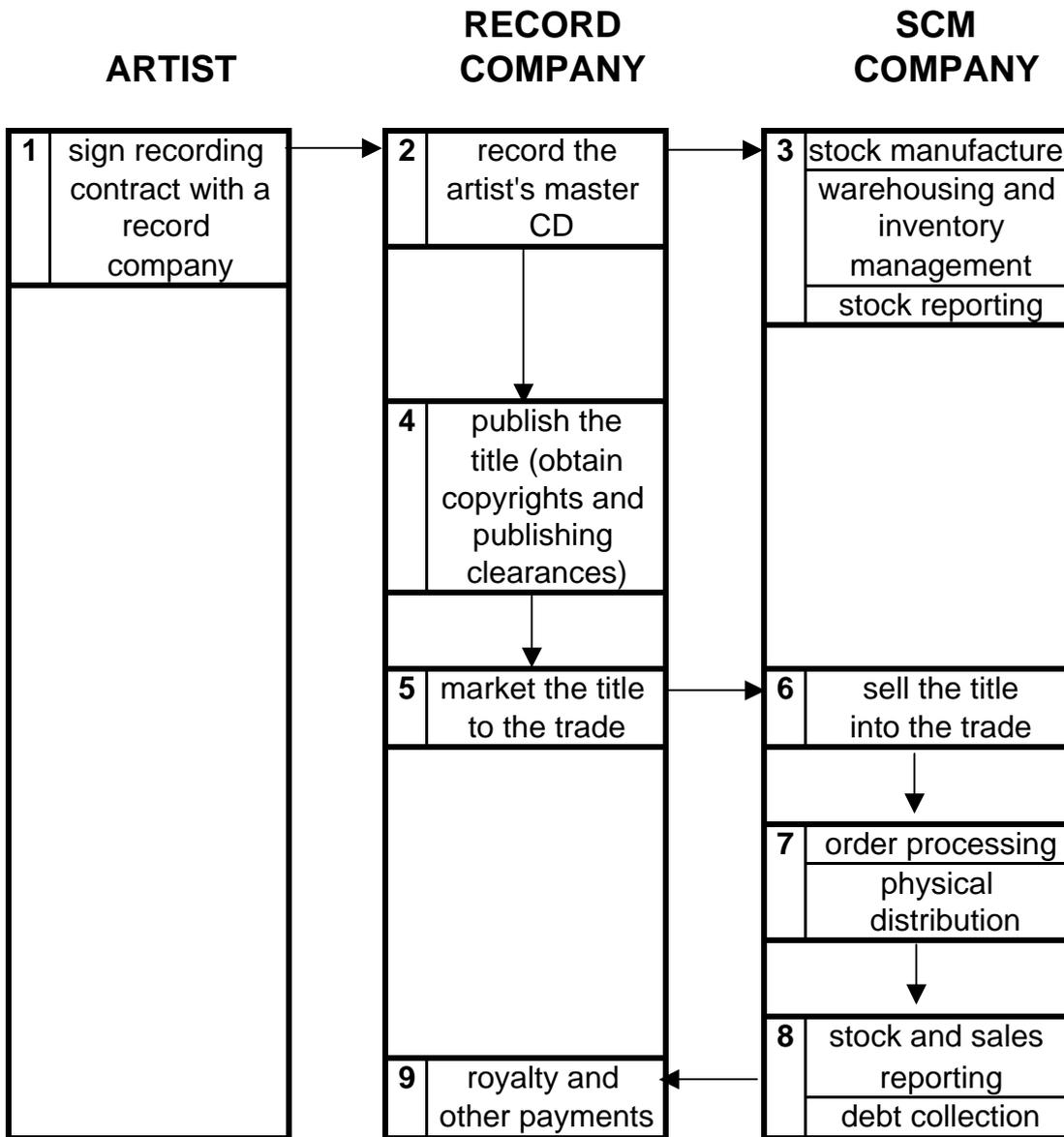
All other functions, *i.e.* controlling the manufacturing process, warehousing the stock, the sales function, inventory management, physical distribution and debt collection are managed and controlled by the appointed SCM company. Refer to the schematic

diagram of the three models in Figure 1.2, as well as to the simplistic diagram of the outsourced model below.

Figure 6.1 A schematic diagram of MODEL C

Source: Own research.

The logistical processes of MODEL C are documented in points 6.2 to 6.10 on the following pages.



6.2 Contracting the artist

In MODEL C, as in the previous two models, artists or bands are still contracted by, or sign-up with record companies (be it an individual record company or one of the five Majors discussed in Chapter 2 under point 2.5.2.1). The record company's main responsibility is directly toward the artist, *i.e.* the management and promotion of their careers. Most other functions are *outsourced* to one specialised supply chain management (SCM) company. The eight proposed processes that follow the contractual phase are discussed in points 6.3 to 6.10 below.

6.3 Manufacturing

The record company, in consultation with the artist, will decide on a suitable number of units (CD, tape, DVD and / or video) to be manufactured. If it is a brand new, untested and unknown artist, as little as 200 units may be manufactured. On the other hand, if the artist is already well known, has a successful previous release and has an established following, it is likely that the record company will invest heavily in any future recordings. Since money will be spent on marketing the new title, it will take a calculated risk on the amount of new units to be manufactured.

6.3.1 Procuring components from strategic partners

In the outsourced MODEL C, the buying of the best product at the best price is one of the main functions performed by the supply chain management (SCM) company on behalf of its clients, the record companies. Important aspects when procuring components, as seen from the SCM company's point of view (Jessop & Morrison 1994: 9 – 10; Hines 1994: 271 – 288; Lynch 2000: 57 – 83; Atkinson 2001: 15 – 18; Burgelman 2002: 137 – 140), include the following:

- (a) In-house manufacturing facilities
Rather procure components (instead of manufacturing them) when the necessary facilities to manufacture are not available in-house, and money can be invested more productively somewhere else. SCM companies are not manufacturers. They must therefore rather concentrate their efforts on their core business, which is offering a complete supply chain *management* solution to their clients and outsource the manufacture of the CD and other units.

- (b) Outsourced buying
Usually companies in other business sectors, such as specialised manufacturers, will go to great lengths to produce all goods in-house, and only buy those components for which the demand is low and only temporary. Since SCM companies are not manufacturers, they follow the complete opposite policy: they outsource buying, and will procure all components if possible. Only when the prices offered by the suppliers of these goods are too high because of very small volumes, the SCM company may consider producing it in-house.

- (c) Cost of manufacturing
SCM companies must procure when suppliers can manufacture at a better price (usually because of the learning curve effect and manufacturing through economies of scale), than what the SCM company can do it for themselves in-house.

- (d) Safety stock
When making use of third parties to provide the necessary raw materials or components needed to manufacture the client's end-item (*e.g.* the CD, the inlays and the jewelcase), it might be wise to order more than what is needed to fulfil the current order. This safety stock (also referred to as buffer stock) is maintained to prevent an excessive number of stock-outs. Two philosophies, namely JIT (as discussed in Chapter 3 under point 3.2.1) and the 'marginal analysis approach', are generally used to determine the optimum level of safety stock to be kept (Johnson and Wood 1996: 321 – 322, Buys 2000b: 1). Marginal

analysis is a mathematical calculation that involves the calculation of the relationship between the number of units in the safety stock, their total value and their carrying costs. Costs derived from stock-outs must also be calculated and then taken into account when procuring.

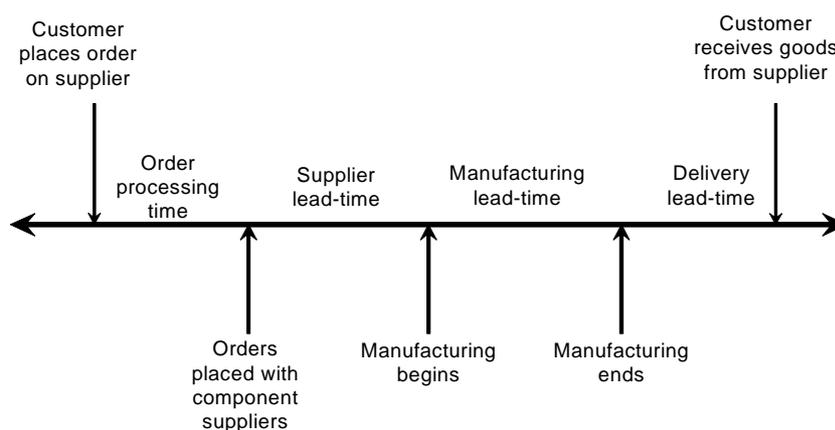
(e) Regulatory limitations

Sometimes a product is protected by patent- or copyrights, which prohibits own manufacturing. This automatically leads to a forced buying situation.

6.3.2 Lead times

After a record company has placed its order for stock to be manufactured on its SCM partner, the SCM company will in turn place a similar purchase order on its preferred supplier for the manufacture of the stock. A phrase that is often used in this context is lead-time, which simply refers to a planned delay before something can take place. Refer to figure 6.1 below for a lead-time time line. The two participants in this time line are the customer (in this case the SCM company) and the supplier (the component supplier, *e.g.* the CD manufacturer).

Figure 6.2 Lead times for a make-to-order company



Source: Own research.

Anderson (1994: 6) also identified four different types of lead-times, which are discussed below (refer to the time line in figure 6.2 on the previous page):

(a) Delivery lead-time

The delivery lead-time is the time it takes for the physical delivery to be executed *i.e.* delivered from the supplier to the customer (which in this case is the SCM company which placed the order for stock).

(b) Operational lead-time

The operational lead-time is the time it takes to complete a single operation, for example the manufacture of one of the components of the finished CD.

(c) Manufacturing lead-time

The manufacturing lead-time is the total time necessary for completion of all the manufacturing operations of a product, for example manufacturing the CD, the jewelcase and the inlays and inserting them all into the jewelcase to achieve a finished product.

(d) Supplier lead-time

The supplier lead-time is the total time a supplier takes after an order is placed to deliver the goods. Depending on the SLA (service level agreement) between the SCM company and their CD supplier, this total lead time can vary between three days (on emergency or expedited shipments) and up to fifteen working days in busy production times. Refer to Annexure F where different aspects relating to a SLA are discussed.

6.3.3 Costs of holding inventory

Inventory costs fall into a variety of categories, with the dominant cost being tied-up capital. By keeping stocks of any kind, a business forgoes the use of the funds it might raise by selling those inventories (or not purchasing them in the first place). In MODEL C, just as in the current MODEL A, the record company is responsible for this inventory

cost. Even though the SCM company places the order to manufacture on its supplier and also keeps the stock in its own warehouses, it immediately creates a duplicate invoice to debit the record company with all the manufacturing costs incurred. Below are listed some of the other main inventory holding costs (Anderson 1994: 20 – 21; Lynch 2000: 86 – 89; Atkinson 2001: 18):

- (a) The building itself
The cost of the space it takes up, *i.e.* the actual warehouse cost of the physical building.
- (b) Operational warehouse costs
Additional costs of running a warehouse like heating and lighting.
- (c) Handling costs
Handling costs of all kinds usually increase with increasing stock volumes. More people and more machinery are needed to achieve the same output when quantities increase.
- (d) Insurance costs
Goods held in store must usually be insured. The higher the amount of stock that is kept in the warehouse, the higher the total monetary value of the goods become and the higher the insurance premiums will be.
- (e) Storage costs
Often these goods need to be protected from environmental damage, which adds additional costs such as racks, pallets, packaging and others.
- (f) Costs incurred from theft
Allowances need to be made for petty pilferage and shrinkage.

(g) Stock obsolescence

The biggest cost of holding inventory in the recording industry, with its unpredictable and sometimes very short product life cycles, is the cost of stock obsolescence.

6.3.4 Benefits of holding inventory

Apart from the seven costs of holding inventory documented in point 6.3.3 above, there are, however, also *good* reasons for holding inventory and five of these reasons are briefly discussed below:

(a) Safety stock

Perhaps the most crucial use of inventory is as a buffer to cope with unpredictable variations in the supply or demand process. Failure to keep sufficient inventory levels leads to circumstances in which the demand cannot be met, usually called a 'stock-out' situation. Having an inventory buffer between the processes of supply and demand mean that they become uncoupled from one another, and it is no longer necessary to closely match their rates.

(b) Unpredictable demand

Even when the demand process is predictable and does not vary, there may be good reason for keeping stock if it is difficult to make the supply process run at a constant rate. This is especially true when a business is 100% dependent on an external supplier for its stock. If for instance the CD manufacturing plant *Sonopress* (as discussed in the MODEL A chain in Chapter 3 under point 3.2.3.3) has a particularly busy month, its lead times may increase from the usual average of seven working days to ten or even fifteen working days.

(c) Delivery costs

Larger stock orders are placed on suppliers when there is a fixed delivery cost associated with each physical delivery of goods to the SCM warehouse. In these

circumstances it is necessary to balance the cost of frequent deliveries against the cost of holding stock.

(d) Set-up costs

When manufacturing a music unit (*i.e.* a CD, tape, DVD or video), there is a fixed set-up cost involved for each batch being manufactured (refer to the *Sonopress* pricelist in Annexure E at the end of the thesis). It is therefore more economical to order the maximum units to be manufactured so that these set-up costs can be absorbed by the greater number of units. At both the big South African CD manufacturing plants (*CDT* and *Sonopress*) this initial set-up cost of +/- R2 000.00 is waived on all single orders of more than 2 000 units of the same title.

(e) Seasonal requirements

Occasionally a business may become aware of likely future changes in the market that might induce it to hold increased stock. A good example is the seasonal requirements in the music industry where, for example, an increased demand of gospel music is experienced over both the Christmas and Easter periods.

In summary it can be concluded that, because of the extremely short expected delivery lead-times into the trade (often less than 24 hours with top sellers), purchase orders placed by SCM companies on its suppliers to manufacture stock, must not only be to fulfil current dealer orders, but must be big enough to make stock so that titles will be readily available and can be prepared for delivery as soon as a purchase order is received from a music dealer.

6.3.5 A re-ordering model

6.3.5.1 Determining the re-ordering criteria

One of the most important functions of the record company / SCM company partnership is to ensure that there is always sufficient stock available to fulfil all dealer orders. Record companies must timeously place their stock procurement orders on their SCM partners, where after the SCM company must order these titles without delay from its preferred suppliers.

When a new title is ordered for the first time, the record company will take a calculated risk when deciding on the amount of units to be manufactured (also known as the opening order amount).

On the other hand, while testing the hypothesis statement (MODEL B), a model was developed on which to base the stock quantity *re-ordering* decisions, *i.e.* how many units to order to replenish stock that has been sold.

The three criteria that are used to calculate how much stock to re-ordered are:

- The amount of units sold during the previous week, *i.e.* a five working-day period (**SALES** amount)
- The amount of stock currently in the warehouse (**STOCK** on hand)
- The characteristics or status of the title (**TITLE STATUS**)

The first two criteria (*i.e.* sales and stock figures) are easily determined from the information on the reports produced by the SCM company's MIS (management information system) and are therefore readily available to the record company.

In determining the value of the last criteria (*i.e.* the status of the title), the three most important characteristics that need to be considered and evaluated, are listed below.

These three characteristics are each awarded with a mark out of ten, with 1 being a very poor mark and 10 being the highest possible achievement.

(a) The status of the releasing artist

Some South African artists or bands are well known and have a large and dedicated local following. Music buyers (the music dealer's customers or end-users) will buy any new release by their favourite local artist, regardless of the amount of publicity or marketing the title has received. If the record company perceives an artist to fall into this 'high-status' category, it will award it a high value on the rating scale, *e.g.* between 6 and 10. If, however, the release is by a new, untested or less popular artist, the record company will award the release with a lower value *e.g.* between 1 and 5.

(b) The number of the release

First releases will automatically be awarded a very low rating on this scale. The more successful titles an artist has released, the higher his / her rating will be. It is suggested that one previous successful release is awarded with a 1 on the scale, two releases with a 2, three releases with a 3 and so on. Some very successful artists may have released more than ten previous albums, but the maximum mark that can be awarded remains a 10.

(c) The amount of marketing performed

An extensive marketing campaign warrants a high mark on this scale. The record company must judge its marketing exposure according to the following four criteria:

- Amount of money spent on television, radio and printed advertisements
- Amount and quality of marketing collateral produced (*e.g.* posters, in-store displays, flyers, caps, T-shirts and others)
- Amount of free publicity received

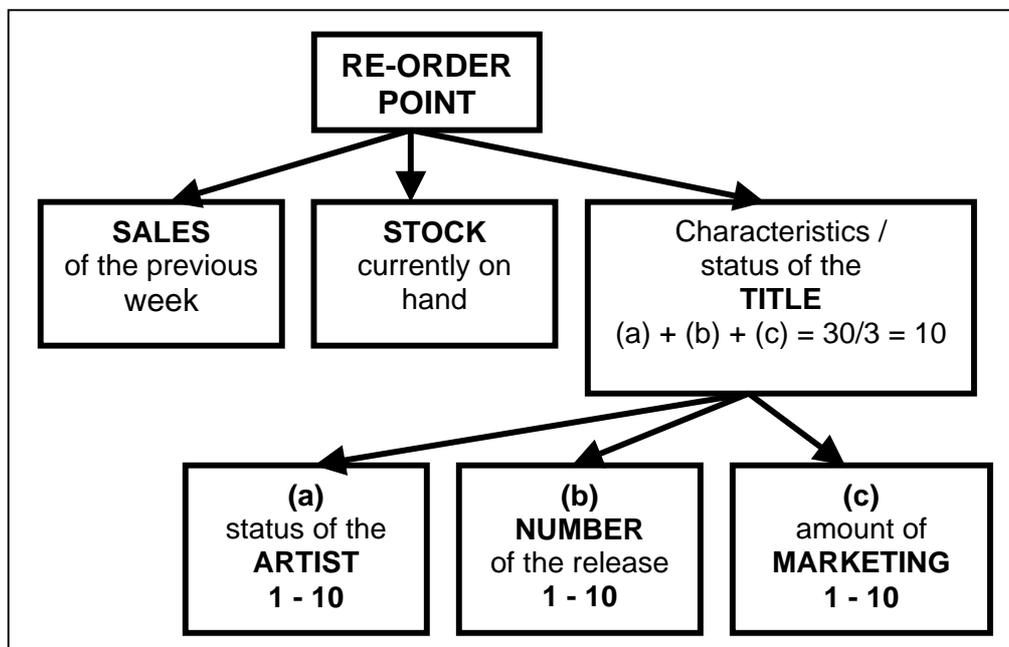
- Amount of public appearances by the artist, such as autograph signing sessions attended and the amount and extent of concerts and tours undertaken and performed

6.3.5.2 Calculating the quantitative value

The three different values (as listed in points a, b and c above) awarded to the release (to the specific title) are added together and divided by the amount of criteria used to calculate the status of the title, which in this case is three. Once again a value out of ten will thus be achieved ($a + b + c = \text{value out of thirty}$, divided by three equals a value out of ten). A detailed example of such a calculation can be found in Annexure G at the end of the thesis.

In order to simplify the re-ordering model, refer to figure 6.3 below for a schematic breakdown of the explanation above.

Figure 6.3 Schematic re-ordering model



Source: Own research.

The characteristics or status of the released title thus now has a quantitative value awarded to it, *i.e.* a mark out of ten depending on the status of the artist, the number of the release and the amount of marketing performed. When an album has a cumulative value of one to three, it is seen as a poor release. A value between four and seven is termed average and a value between eight and ten is judged an excellent release. Refer to the three tables in Annexure G where the re-ordering formula was used to determine the re-ordering values.

6.3.5.3 The re-ordering formula

The aim of stock-holding must be to have just enough units of stock available to fulfil orders, without having a too big surplus of stock which might become obsolete. According to the re-order model, it can therefore be deduced that the stock that is currently on hand in the warehouse must at least equal the sales amount of the previous week. If the stock on hand is less than the sales value of the previous week, more needs to be procured. The amount to be procured can be calculated by using the following very simple formula:

$$\text{SALES} = \text{STOCK} + (\text{RE-ORDER amount multiplied by STATUS multiplication value})$$

$$\text{SALES} - \text{STOCK} = \text{RE-ORDER amount multiplied by STATUS multiplication value}$$

$$S - T = R \times A$$

The units of the equation are:

- SALES: the sales amount of the previous five day-working week
- STOCK: the stock currently on hand in the warehouse
- RE-ORDER amount: the amount of units to re-order when the stock amount will fall below the critical safety stock level

- STATUS multiplication value: the characteristics or status of the title as determined in point 6.3.5.2 above, where the title was awarded with a mark out of 10 (refer to the explanations above). In order to use this formula, the following multiplication values are used:

Title status value of between 1 and 3 implies a multiplication value of 1

Title status value of between 4 and 7 implies a multiplication value of 1.1

Title status value of between 8 and 10 implies a multiplication value of 1.2

Below the re-ordering model is further explained through the use of an example:

Calculation example:

SALES for the previous week: 2 000 units

STOCK currently on hand: 800 units

Formula: $S - T = R \times A$

If the title has a poor status (value of 1 to 3):

$$\begin{aligned} 2\ 000 - 800 &= 1\ 200 \times 1 \\ &= 1\ 200 \text{ units to be re-ordered} \end{aligned}$$

If the title has an average status (value of 4 to 7):

$$\begin{aligned} 2\ 000 - 800 &= 1\ 200 \times 1.1 \\ &= 1\ 320 \text{ units to be re-ordered} \end{aligned}$$

If the title has an excellent status (value of 8 to 10):

$$\begin{aligned} 2\ 000 - 800 &= 1\ 200 \times 1.2 \\ &= 1\ 440 \text{ units to be re-ordered} \end{aligned}$$

In this model, when a title is perceived as having an above average or excellent status in the market, a greater amount of replenishment stock is thus ordered in anticipation of higher future sales. Titles with a lesser status warrant a smaller re-ordering quantity.

6.4 Warehousing

Once the master CD has been replicated by the duplication factory, the stock is delivered to the warehouses of the SCM company. When the stock is received, the units are subjected to a very strict quality control process. All the boxes are opened and checked that they contain the correct quantity of the correct title. The jewelcases are randomly checked for damages. The boxes are weighed on sensitive scales to make double sure that they contain the correct amount of units.

When the receivers are satisfied with the quality and quantity of the consignment, the goods are received into the warehouse, both physically as well as onto the warehouse's MIS (management information system). The goods are stored in the pre-allocated bins for easy and efficient inventory management and control.

6.4.1 Distribution Resource Planning (DRP)

DRP is an inventory method helpful in determining inventory requirements in warehouses. Whereas materials requirement planning (MRP) deals with production inputs, DRP involves finished products (Johnson & Wood 1996: 345 – 346; Buys 2000b: 1; Mayes 2000: 1 – 2; Hossain, Patrick & Rashid 2002: 206 – 212). The key to DRP is centralised order processing by the SCM company, especially when the SCM company owns or operates more than one warehouse. The receiving of finished goods (*i.e.* music CD's) at different regional warehouses or distribution depots around the country, can easily result in an unbalanced inventory of these items throughout the company's regional warehouses.

When the DRP principle is followed, all client orders from the trade are processed at one location, and then the end-items or finished products are sent to the appropriate

warehouse in order to be delivered to fulfil the order, as well as to replenish the inventory that was just sent out on the dealer order. The result is that all stock is then balanced throughout the warehouse system. The central inventory planner, in conjunction with the procurement department, can then ensure that, if shortages do occur, they can be evenly spread amongst warehouses, so that no client needs to accept complete stock-outs while others are receiving almost all of their requested shipments.

6.4.2 Quality control and protection of intellectual property

Control over the quality of all goods that leave the warehouse and are delivered into the market, already started with the SCM company's strategic choice of suitable suppliers. Components of exceptional quality are needed to deliver finished products of the same exceptional, uncompromisable quality. In the competitive recording industry, nothing than absolutely the best is good enough. Products in this industry have:

- A relatively high monetary value
- A high intellectual value
- A high standard of technological advancement - they are expected to perform perfectly every time

Tying in closely with the principle of ensuring and adhering to high quality standards, is the principle of protecting intellectual property. SCM companies often have competitors as clients (*i.e.* different record companies). The SCM company should be able to guarantee each and every one of its clients that the technological and intellectual content of their products are safe.

6.4.3 Pro-active warehouse management

Matthysen (2000: 2) identified how the combination of the automation of clerical supervisory functions, together with the delivery of information, can reduce the time spent on administrative activities and provide SCM warehouse supervisors with the information they need to plan and organise the warehouse operations. Efficient and pro-

active warehouse management will lead to quicker lead-times and improved customer service. Improved warehouse management can generally be achieved by adhering to the following five important principles:

- (a) **Consistent application of business rules throughout the SCM company**
Applying this principle will ensure that every employee, being a manager, a supervisor or a warehouse worker, clearly understand what is expected of him or her. Ultimately, when all employees are treated equally, they will automatically conform to the same working standards and adhere to the same set of business rules and principles.
- (b) **Systematic push mechanisms**
These should be in place to alert supervisors to exception identification. When orders are 'pushed' through the warehouse, they acquire immediate attention. If they are not dealt with as soon as possible and finished on time, the next order will come pushing from behind – leading to a build-up of work to be done.
- (c) **Collection of activity information**
By performing this activity, the objective assessment of productivity can be achieved. Supervisors, or any person in a management position over-seeing workers, need accurate information to be able to assess the capabilities, competence and productivity of the workforce.
- (d) **Scheduling applications**
Scheduling applications will allow the optimal use of the workforce while still adhering to company standards and legislation. When emergency orders that need to be expedited through the channel are received, additional workers can be contracted to help the SCM company keep its delivery-promises.
- (e) **System interfaces**
Interfaces with other systems facilitating a two-way exchange of information, feeding business processes such as billing and extracting activity and workload

information from operational sources, is a necessary tool when combining above-mentioned functions in an organisation.

6.4.4 Designing a functional warehouse

6.4.4.1 Preliminary planning steps

Various authors have documented ways in which to best design and manage a logistics warehouse (Jenkins 1990: 158; Lynch 2000: 103 – 126). Through primary and secondary research and various personal interviews, a six-step plan was identified and formulated to prepare the functional layout of a warehouse. These steps will briefly be discussed in order to provide some background information on the preliminary design and layout of a SCM company warehouse.

Step 1: Determine parameters

Initially company management must decide what will and will not be included in the warehouse set-up, as well as what kind of warehouse needs to be designed (*e.g.* purely a distribution depot or a complex warehouse with various functional areas such as inbound distribution, receiving, assembly, picking, packing and outbound distribution). An evaluation must be done on what the existing space and equipment resources and requirements are.

Step 2: Establish all objectives.

While establishing the project's parameters, the objectives may in turn become evident. This is because *what* is to be studied (within the parameters) is inseparable from *why* (the objectives). Some objectives may be to:

- Provide minimum-cost warehousing even though sacrificing service
- Provide minimum-cost warehousing while maintaining the established levels of service
- Provide a better service (in quantified terms) than the competition regardless of the cost

- Provide a competitive service (in quantified terms) at the lowest possible cost

Step 3: Gather relevant information

Information needs to be gathered in order to determine how best to conform to these above-mentioned directives. As with any complex problem, the solution becomes easier in direct relationship to the amount of relevant information that is available to the decision-makers.

Step 4: Analyse the information

As in any research process, none of the gathered data or information must be ignored. The information must either be assigned a quantitative value, or alternatively it can be decided that the particular data is irrelevant to the current research.

Step 5: Implement the layout plan

No project is complete once the best plan has been devised, even when it is in blueprint or a miniature model form. Implementation is the next crucial step in the planning and erecting of a functional SCM warehouse. The effective, efficient and most orderly way in which to implement the warehouse layout is to start with an empty building that has all the storage racks and other fixtures installed and the floors and ceilings properly lined. Then as the inventories arrive, they are put away and stored according to the pre-established plan. In future, no outbound shipments should be made until inventories and paperwork systems are in place and the MIS is fully functional.

Step 6: Review the initial plan

The last step is to evaluate the entire plan and its implementation and to reconcile any differences. Constant review and analysis is necessary to ensure that the warehouse continues to fulfil the company's needs.

6.4.4.2 Physical lay-out

Information gathered during the above-mentioned Step 3 include many facets. The physical layout of the warehouse must be in line with the major functions it will be performing. Various trade-offs will need to be made in the warehouses of the SCM company, three of which are listed below:

(a) Space devoted to aisles versus space devoted to racks

As aisle space increases, storage capacity decreases. This implies that aisles must demand equal engineering attention as storage areas, and both have to be planned together to arrive at a functionally efficient warehouse.

Probably the single most important element affecting aisles is the handling equipment employed. It is calculated that a typical order picker spends 60% of his / her time in a warehouse moving from location to location, and this is why a worthy objective of a layout design should be to lose the least space possible, in order to minimise travelling distances and time (Johnson 1996: 364). This is why narrow-aisle lift trucks, side loaders, 180-degree turret lifts, deep-reach forks and stacker cranes were developed – mainly to minimise space consumed in aisles.

Another important consideration regarding aisles is that both sides of the aisle must offer access to stored goods. A warehouse should never be designed with an aisle running along the side of a wall. Also, a single row of pallet racks with aisles on both sides of the rack should never be used. Racks should be back-to-back so that aisles permit access to storage on both sides.

(b) Horizontal versus vertical high-rise layout

This trade-off arises between building costs that decline on a cubic-metre basis as a building is built higher, and warehouse equipment costs that will necessarily increase. Building height translates to storage height. Height is even more important than width and depth in determining total storage capacity. Changing

this dimension, if needs be, also has the least effect on building costs for the same increase in capacity.

In the past, the implementation of high storage was not always possible because equipment manufacturers did not provide for reaching higher. The high-rise hoists necessary to perform this function, have only been developed fairly recently, but is already in use in all major SCM company warehouses.

(c) Productive production flows

Product titles that are ordered and despatched most often and in the greatest volume, must be stored in the most efficient area for material handling. This simple notion can reduce the warehouse worker's material handling and travel time by up to 50% (Jenkins 1990: 176).

6.4.4.3 Vertical space

Taking all of the above-mentioned elements into account (refer to points 6.4.4.1 and 6.4.4.2 above), it can be concluded that the single storey warehouse construction is more productive and economically viable to be used as a SCM company warehouse. The following six reasons summarise why it is thus better, in most cases, to erect single storey warehouses:

(a) Volume building cost

The cost per cubic metre of storage space is usually much cheaper in a single storey construction, because the shell can be of lighter construction than is possible with a building having upper floors.

(b) Structural considerations

The weight-carrying capacity of an upper floor is always limited by structural considerations. Forklifts and other machinery or equipment needed to reach high warehouse shelves, are very heavy and their weight will not be supported by a floor that has not specifically been reinforced to support this weight.

(c) Material-handling costs

Material-handling costs are likely to be less in a single-storey warehouse than in a multi-storey building where goods have to be transported up and down between floors.

(d) Electricity savings

More use can be made of natural daylight in a single storey layout, effectively lowering electricity costs.

(e) Lower ventilation costs

Adequate ventilation is cheaper and easier to arrange when there is only one ground level floor involved.

(f) Efficient equipment

Modern high-rise equipment enables the efficient use of vertical space from a single ground floor, effectively making it unnecessary to have more than one storey.

6.4.5 Outsourced warehousing

A great amount of capital equipment, human resources and management expertise are tied up in the warehouses itself, as well as in the management of the stock there-in (Fawcett *et al* 1992: 113). However, logistics and supply chain managers claim that the existence of warehousing activities can be justified on the following grounds:

(a) Assembly area (make- and break-bulk)

In its warehouse assembly areas, SCM companies can assemble end-items from supplied components (for example manually inserting the actual CD or the inlays into the jewelcases). SCM company warehouses are also used to facilitate break-bulk operations, where large bulk quantities are broken down into smaller individual orders before onward transit to the client, or the client's client (*i.e.* the music wholesalers, dealers and retailers in the trade).

(b) Safety stock

Warehouses provide a buffer between the rates of supply and manufacture, and that of demand. The supply of the end product can be planned in advance, whereas actual demand from clients and their customers are usually unpredictable. In the event of a sudden unexpected increase in sales demand, or component supply failure, inventory held in the warehouse (also referred to as safety stock or buffer stock), can then be used until the problem is resolved or an alternative source is found.

(c) Reduction of costs

By warehousing stock, production cost savings can be optimised by permitting longer and larger production runs which will minimise set-up and changeover costs. This will help keep manufacturing and processing costs down by means of economies of scale. Refer to Chapter 3 (point 3.2.3), as well as to the *Sonopress* pricelist in Annexure E where the high set-up costs of CD manufacturing are discussed.

(d) Seasonal demands

Anticipation inventory can be created, especially for goods with a seasonal demand pattern (e.g. gospel music that enjoys increased sales over the Easter and Christmas periods). In order to make provision for such demands, and yet maintain consistency in levels of production, goods to service this seasonal demand sometimes need to be built-up over an extended period of time.

(e) Customer service

SCM company warehouses aid in the maintenance and improvement of customer service levels. The closer their clients' stock is located to the market, the greater the availability of goods to fulfil individual orders, and the shorter the lead times become. When the points of supply and demand are far removed from one another, providing high levels of customer service become more demanding on the distribution system, as well as more costly. SCM companies can use their logistics and distribution management function to set up these

warehouses to help maintain customer service levels in a more cost-effective and efficient manner.

In addition to these five reasons for justifying the existence of warehouses, there is also a need for companies to protect their investment in their inventory. The most convenient way to achieve this, is for them to stock their goods in a secure and suitable environment such as the warehouse of their outsourced SCM partner, where the risk to inventory from damage, deterioration and unauthorised removal will be minimised.

At any given time, a record company must know its exact stock quantity on its SCM partner's premises. The relevant SCM account manager must generate reports from the MIS and forward it to its client, usually on a weekly or monthly basis (depending on the predetermined SLA or contract). Information included in these reports deal with the quantities on hand, information of possible work in progress, information on stock that is currently in transit and all sales information. Refer to Annexure H at the end of the thesis for examples of these reports.

6.4.6 Geographic location

6.4.6.1 Factors influencing location

Many factors influence facility location. Inappropriate locations could result in poor service to customers, high operating costs, excessive loss due to theft and unnecessary high freight costs. The difference between carefully selected locations and random selections could well mean the difference between a successful warehouse system and one that is doomed to failure. The three factors discussed below should all influence the SCM company's warehouse location decision to a greater or lesser extent:

(a) Infrastructure and transport

Infrastructure and the available transportation services are in many cases the most important location considerations. The warehouse should be located in such an area as to permit the lowest total inbound and outbound freight costs.

Transportation costs are relatively easy to measure and highly visible. It also directly affects inventories as related to transit times, the likelihood of damage and service reliability.

The warehouse location decision as influenced by the availability of adequate transportation facilities, can also take on a more personal nature. A different type of transportation that should be considered is the one that involves moving people, more particularly employees, because the overriding consideration in conducting business is, and should always be, people. Therefore, the accessibility of the warehouse to employees and others who come to conduct business there, is also an important consideration in determining the warehouse location.

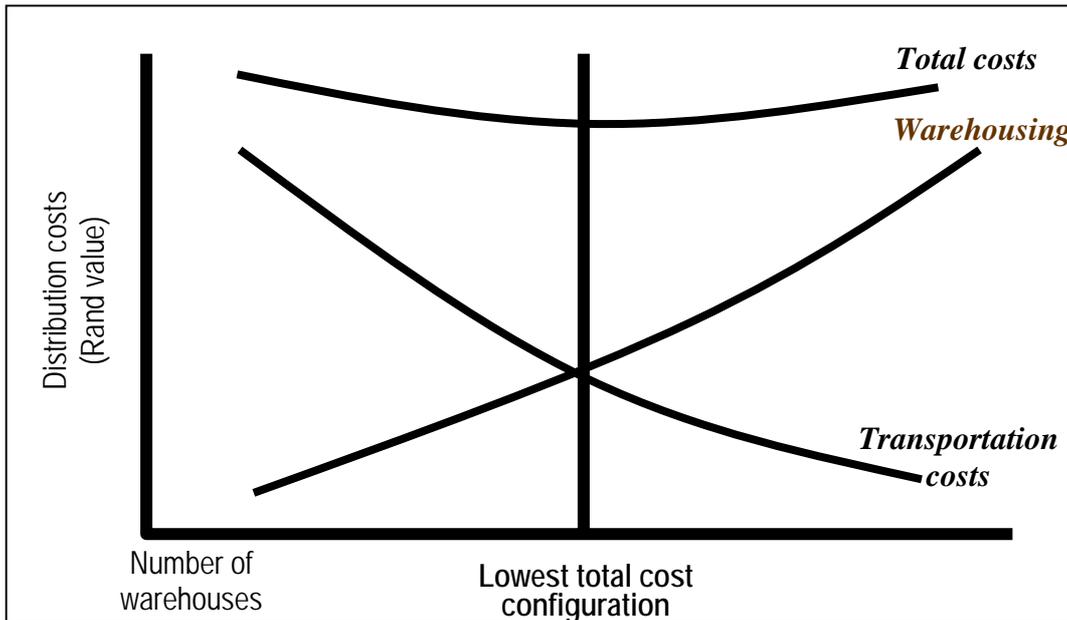
(b) Community resources

Being close to a labour force and other community resources are location necessities of a more personal nature, but is just as important as any other operating requirements. While labour availability is not as great a concern in warehousing as it might be in many other aspects of the industry (such as those requiring a greater number of workers, or more specialised training), it is still an important factor to take into consideration.

(c) The client

Being close to the client and its market is of crucial importance to any SCM company and its warehouses. As discussed above, delivery times will be directly affected by the location of the warehouse. Many SCM companies set up strategically placed warehouses (or just some kind of presence in the form of a distribution depot) in different parts of the country to better service all their clients' physical distribution needs. A trade-off needs to be made between transport costs, and the cost of setting up a number of strategic warehouses or distribution depots around the country.

Figure 6.4 Relationship between warehouse and transport costs



Source: Fawcett, McLeish & Ogden. 1992. *Logistics Management*.

Figure 6.4 above depicts a well-known graph on the relationship between warehouse costs and transport or physical distribution costs.

6.4.6.2 Factors influencing delivery lead-time

Various factors directly and indirectly influence the delivery time (or lead-time) from the SCM company into the trade. By enlisting primary research (*i.e.* the personal interviews, telephone conversations and electronic mails with managers at SCM, logistics and freight companies as discussed in Chapter 5 under point 5.4.3.2), four factors were singled out as having the greatest influence on the SCM company's delivery lead-time. Through interviews, these factors were confirmed by the discussions of Section (d) of the Questionnaire (Annexure I). These factors are listed and discussed on the following page:

(a) Client Service Level Agreements

The time available or required to meet the client's stated service objectives are determined by the earlier agreed-upon SLA between the SCM company and its client (the record company), as well as with its client's client (the trade). Refer to the proposed outline and content of a SLA in Annexure F at the end of the thesis. Sometimes seen as detrimental to normal business practice, preference is often given to big, important clients who are responsible for a large percentage of the SCM company and the record company's profits. Sometimes special arrangements need to be made to handle emergency orders that need to be delivered urgently.

(b) Rates payable or receivable

Taxes and subsidies can have a huge impact on choosing a location to set up a warehouse. Some real estate taxes are based on market value, others on initial cost. Complicating this even more, is the fact that percentages and ratios of the market value and initial cost are used to determine taxes to be paid.

(c) Available capacity

The availability and costs of transportation to make these required and agreed-upon delivery times possible should be considered. On some occasions, even SCM companies will need to outsource their physical distribution or delivery workload if they are unable to accommodate it all in-house.

(d) The distance factor

The travel distance to the record company's customers, which can be very long and costly when delivering to outlying dealers in small towns must be taken into account.

(e) The time factor

The actual travel time to customers, which radically multiplies when goods have to be delivered to outlying rural areas with a poor infrastructure or road network, also affects delivery time. Most small South African towns have a shop that sell

music, and the SCM company need to carefully plan their deliveries to these remote areas in order to make it an economically viable process.

Academic authors and business leaders agree that the two most important and main all-encompassing considerations to locate close to customers, are of a psychological and physical nature (Jenkins 1990: 76 - 81). Psychologically, customers generally 'feel' that if their SCM company, or at least some kind of presence (like a warehouse of some kind or a distribution outlet) is close by, they are better off to deal with them than with suppliers that are more distant. The physical part of this is, as mentioned above, that it is normally the shortest distance between the SCM company and its customer that result in the least travel time.

6.5 Marketing

According to Mariotti (2002: 6), marketing is the practise of understanding the needs and wants of customers, creating products or services that meet those customers' needs and wants, and then communicating this both internally to the organisation which must create and deliver the products or services and also externally to the customers for whom they're intended, so they will desire and buy them. In an old but thorough and comprehensive definition of the marketing function (Hisrich & Peters 1991: 4) further explained that marketing is "the process by which decisions are made in a totally interrelated changing business environment on all the activities that facilitate exchange in order that a targeted group of customers are satisfied and the defined objectives accomplished."

6.5.1 The business plan

Marketing is an integral part of any company's business and the activity should be contained as a detailed description in the company's business plan. A business plan is a statement of the actions and resources required by a business to sustain and grow its activities (Fewell and Wills 1993: 172; Craft 2000: 1 – 20). A business plan must therefore precisely define the business, as well as identify the company's goals (Barrow

2001: 1 – 18). It helps to allocate resources properly, handle unforeseen complications and guides company management to make the right decisions. A business plan serves as a company's resume and must contain the following supporting plans (www.be.up.co.za/businessplans):

- A Strategic plan which substantiates the viability of the venture. It should contain a summary of the vision and mission of the company, as well as strategic priorities and objectives
- The Production or Operational plan which includes a description of the company's physical operations and operational infrastructure
- An Organisation and Management plan which includes a description of the type of business, the structure of the organisation, key competencies of the team and the human resource budget and activities
- A Financial plan which should make provision for capital requirements and financial strategies, loan securities, income statements, cash flow statements and balance sheets
- The Marketing plan that should include a detailed description of the product or service, the position of the competition in the market, a summary of the company's clients and customers, information on the market size and market share, the pricing structure, sales forecast, the promotional strategy and the budget. The content of a detailed marketing plan is discussed in more detail in point 6.5.2 below

6.5.2 The four marketing questions

In MODEL C (the outsourced SCM model), the marketing of an artist and his / her releases, remain the responsibility of the record company that contracted the relevant artist or band. The first important point related to marketing is that a business' strategy and the marketing function are inextricably intertwined. The record company must develop a strategy and decide what to sell, to whom, where and how.

Deciding on what kind or type of music will sell is not obvious. There are some occasions (*e.g.* with a follow-up release of a very popular artist's album) when it should be simple for the marketing department to know or predict what will sell. There are records and reports of what has sold in the past and market research information about what customers buy (refer to the information regarding pas sales figures contained in the *Recording Industry of South Africa's* website at www.risa.co.za). However, the problem remains that everything marketers know is about the past or based on conjecture on the part of others. Everything that will happen occurs in the future, which is uncertain.

If the record company's marketing team has managed to sufficiently answer the 'what' to sell question, then come the 'to whom', 'where' and a little later, the 'how' questions. Deciding 'to whom' to sell a product is perhaps marketing's most critical job (Mariotti 2002: 9). If the target market is picked well and researched and studied, the new music release will have a chance to succeed, but if the market is picked poorly, the release and even the performing artist will almost certainly fail.

The 'where' to market and sell question can mean the geographic location of the chosen target market or the scope of the geography the record company chooses to target. This question is important because it is also about focus, which means deciding where the company is going to focus and spend its resources to achieve the desired results.

The fourth marketing question, being 'how' to sell the product, will be discussed in point 6.5.3 below as part of the record company's comprehensive marketing plan.

6.5.3 The marketing plan

The record company (in conjunction with their SCM partner) must draw-up a marketing plan, in which the basic four marketing questions will be answered (*i.e.* 'what', 'to whom', 'where', and 'how' as discussed in point 6.5.2 above). In MODEL C, it is the record company that is responsible for the marketing of its artists and their titles. Through both primary and secondary research it was determined that a successful marketing plan must include detailed information relating to the six important aspects

discussed below. The items included in the proposed marketing plan of *BE at UP (Pty) Ltd* (the Business Enterprise department at the University of Pretoria) were also considered (www.be.up.co.za/businessplans).

A marketing plan must research and study the following six aspects, and special attention must be paid to the points highlighted under each section:

(a) Markets

- Define the market, the market size and the probable growth rate
- Define any primary target segments
- Perform a detailed current and projected situation analysis
- Perform a market opportunity analysis (*i.e.* review external opportunities)
- Perform a competitive analysis (*e.g.* benchmarking of internal strengths and weaknesses compared to those of the competitors)
- Perform continuous market research

(b) Products

- Define the relevant product (the artist, album title, music genre, release date and other product criteria)
- Define the features and specifications of the product (*e.g.* the product format such as CD, cassette tape, video or DVD)
- Define the product line structure (*e.g.* a gospel CD line or a dance music series)

(c) Sales (also discussed in point 6.6 below)

- Develop sales strategies (the ‘what’ to sell marketing question is answered here)
- Decide on the sales implementation steps (answer the ‘how’ to sell question, also refer to the discussion on selling skills in point 6.6.1 below)
- Formulate specific sales tactics or operational action plans

- (d) Promotional activities
 - Develop a communication plan (both internal and external)
 - Develop the advertising and promotion plan
 - Decide on the packaging of the end-product (*i.e.* the design of the inlay and the printing on the CD)
 - Confirm release dates with launch plans (consider timing and available resources)
 - Decide on ways of measurement and continuous feedback methods

- (e) Operational activities (to be executed by the SCM partner company)
 - Develop sourcing plans (*i.e.* manufacturing or procurement of both the primary product, *i.e.* the CD, tape, video or DVD, as well as any marketing collateral such as posters and pamphlets)
 - Confirm production plans (in accordance with the preferred supplier)
 - Develop detailed distribution plans (both warehousing and physical distribution)
 - Develop order fulfilment plans (*i.e.* order entry on the SCM company's MIS, as well as picking, packing, invoicing and any other order fulfilment activities)
 - Implement an after-sales customer service by utilising 'telesales' for example (also performed by the SCM company, but with close conjunction with the record company)

- (f) Economic aspects
 - Determine the feasibility and viability of the release of the specific title
 - Perform a detailed economic analysis (to justify the investment in studio time, the manufacturing costs and the marketing expenses)
 - Determine budgets
 - Analyse the ROI (return on investment)

It is clear to see that marketing is not simply sales - sales is only one aspect of a complex marketing strategy (refer to the discussion on the sales function in point 6.6

below). Sales are different in that it involves the presentation of the outcomes of marketing's efforts. However, since marketing and the sales effort go hand-in-hand, it is clear to see that it is crucially important for the record company and SCM company to work closely together in both these functions. Neither of the two functions (marketing or sales) can be performed optimally if they are not executed in close collaboration with one another and with the other party.

6.6 Sales

While the marketing of artists and their titles was performed by the record company, the responsibility of the sales effort in MODEL C falls into the hands of the SCM company. The SCM company must employ nation-wide sales executives to sell the titles of all their clients, *i.e.* the various record companies. This sales team must be highly motivated and knowledgeable about the product (*i.e.* the music titles) that they are selling. Music buyers are notoriously difficult to sell to, they will try to negotiate to either pay as little as possible, or alternatively they will want some free stock or other incentives before placing their orders.

6.6.1 Selling skills

The debate on whether a true salesman must be born or can be made, is still widely discussed and debated. Miller (2001: 206 - 207) identified the following five sales skills that every successful sales executive should possess:

(a) Product knowledge

This simply means having, knowing and understanding information about the goods or services that are being sold. A sales executive selling the titles of a record company, must know to which music genre each title belongs (*e.g.* gospel, dance, blues, rap or other), as well as any other relevant information such as who the performing artist is, what the best tracks on the album are and what the release date was.

(b) Selling skills

A sales executive must be able to show sales cycle control, qualifying skills and a strong value creation ability. Refer to the practical usage of these selling skills in point 6.6.2 below.

(c) Communication skills

Although a sales executive must possess various important and diverse communication skills, the three most important ones seem to be:

- Behaviour profiling (in order to correctly judge and interpret the type of buyer, as listed below under point 6.6.2)
- Effective listening skills
- Effective negotiating skills

(d) Presentation skills

Apart from the important in-person or group presentation skills, a successful sales executive must also possess over-the-phone presentation skills that are used for instance in ‘telesales’ or selling over the telephone.

(e) Personal growth

Personal growth, learning and growing skills are all trademarks of a successful sales executive.

6.6.2 Types of buyers

Academic authors and managers in the field have identified various different types of buyers and how sales representatives can cope with each of them (Miller 2001: 213 – 218; Zoltners 2001: 122). Personal interviews with sales executives employed by record companies and SCM companies have mostly concurred with these findings. Refer to the sources of knowledge in the previous chapter under point 5.4.3.2 – sales representative from independent South African Record companies such as *Select*, *Fantasia*, *Rhythm Records* and *African Cream* were interviewed, as well as the sales team of a supply

chain management company called *Bowline*. Below is listed a short summary of the combined findings of academic authors and actual sales representatives working in the field.

The ten types of buyers are:

(a) Friendly type

This type of buyer is friendly and sympathetic with everything that is being said, but is usually very difficult to pin down in order to make a decision. The salesperson should try not to get drawn into the 'friendship' but should keep pushing to close the sale.

(b) Talkative type

'Talkers' can easily fill up all the time of the sales call with interruptions and sidetracks and then never gets round to ordering. Talkers are often poor listeners, so the salesperson must be prepared to make his / her point more than once.

(c) Silent type

This type of person says little but listens carefully to what is being said. It is difficult to gauge his / her interest or to know what queries or objections he / she might have to the sale (*e.g.* to the product or the price). The salesperson must try to draw the buyer into the conversation - one way of achieving this is by asking open-ended questions.

(d) The Prevaricator

This buyer talks on a grand scale and is full of promises, but unfortunately the big order just never seems to materialise. The salesperson must try to talk about details and pin the buyer down to place a firm order.

(e) The 'Mule'

Just like the stubborn animal, when his mind is made up, nothing will change it. Mules will often make a wrong decision rather than change their original points of view. The salesperson should not criticise the buyer's original decisions, but should rather try to angle him / her into a more favourable position with regards to the company or the product.

(f) Pompous type

This type of buyer is full of his / her own importance and power, he / she is motivated by status issues and recognition from superiors. The salesperson must try to give credit where credit is due, but still stick to the facts of his / her sales pitch.

(g) Experienced type

This buyer sees through poorly-reasoned arguments, but equally will also recognise a good presentation, product or price. He / she should be treated with respect and given the specifications of the sale upfront. Sales executives have stressed the fact that the salesperson should not try to bluff this experienced type of buyer.

(h) Inexperienced type

New or young buyers will be worried about making mistakes, therefore the salesperson will have a golden opportunity to lead the meeting and teach the buyer as much as possible about his / her company and its products.

(i) Shy type

Shyness is not a measure of lack of experience or intelligence. The salesperson can again use open-ended questions and try to draw the buyer into discussions about the music titles.

(j) Busy type

Their phones are always ringing and people are continuously coming in and out of their offices. The salesperson must try to schedule his / her appointments at the least busy times but must then politely request that the buyer gives him the necessary attention and respect during their allotted time.

The SCM company must meticulously analyse all available information regarding its market and the specific buyers, as well as any other information it can obtain regarding past sales. A good source of information is *The Recording Industry of South Africa* (RISA), since they keep statistics of all local sales figures (www.risa.org.za). The meticulous scrutiny of all relevant information is important because the SCM company must analyse the demographics of each area in order to forecast sales. This includes population characteristics such as age, nationality, occupation and income group. It is safe to assume that a 25 year old Zulu male, working as a labourer in the sugarcane plantations of Kwa-Zulu Natal, would rather buy a music CD by the popular traditional Zulu artist 'Oleseng', who releases gospel music under the *Cool Spot* label (*Cool Spot* is the biggest South African black independent record company), than the latest Afrikaans release by Rina Hugo. The SCM company sales executive will rather sell his / her Rina Hugo title in Afrikaans speaking areas, e.g. some of the towns in the Free State like Welkom or in cities such as Potchefstroom or Pretoria.

6.6.3 Sales management formula

Miller (2001: 58 – 64) developed a very simple formula to manage the success of a company's individual sales executives:

$$\mathbf{R = F \times C}$$

Revenue equals Frequency times Competency

(a) Frequency

In simple terms, it is obvious that any company would want its employees to work hard and do a lot. Frequency relates to the actual amount of work that is

being done in a specific period of time (*i.e.* quantitative output). Unfortunately the communication between company management and its employees is not always very clear. Because they spend a lot of time on the road and are not often in the office, the sales team in particular might not always know what is expected of them. Management must communicate to their staff specifically what they want or need them to do. Good communication will significantly improve the company's and the sales team's chances of success. Below is a list of frequency metrics with which management can measure the output of their sales team:

- Amount of sales calls per week
- Amount of weekly prospects (possible new clients) gathered
- Quantity of reports submitted on time
- Quantity of sales proposals submitted per week
- Amount of demonstrations delivered per week

(b) Competency

While frequency of work is important, the quality of that work is just as important. Any company wants its employees to display a high degree of quality and competency in the tasks they perform. Below is a sample list of various sales competencies:

- Selling skills (discussed in point 6.6.1 above)
- Sales focus
- Presentation skills
- Professionalism
- Sales cycle control
- Customer knowledge
- Negotiating skills
- Customer relationships
- Personal confidence
- Prospecting skills

6.7 Inventory management

In MODEL C, the huge task of stock control and inventory management rests squarely on the shoulders on the SCM company. What makes this an even more daunting responsibility, is the fact that the SCM company is not managing its own stock, but that of its various record company clients.

If the SCM companies has a fully integrated MIS (management information system), this task becomes much more streamlined and easier to manage. The following basic processes regarding stock must be executed and / or controlled:

- Creating new album titles on the system (*i.e.* assigning part-numbers and creating BOM's or Bills of Material for components and end-items)
- Ordering the individual components of the BOM from the relevant suppliers (placing purchase orders)
- Checking and receiving the stock into the warehouse and onto the MIS
- Frequent stock counts to control and verify stock movements and quantities (inventory management and control)
- Entering sales orders from music wholesalers, dealers and retailers
- Picking and packing of sales orders to be delivered
- Generating the necessary documentation to accompany the delivery (*e.g.* the invoice and delivery note)

6.7.1 The Management Information System

It is not a new concept to have a formal computer system in place in order to organise and manage inventory. More than two decades ago, Murdick (1980: 11) formulised the following comprehensive definition of a Management Information System (MIS):

“The system which monitors and retrieves data from the environment, which captures data from transactions and operations within the firm, and which

filters, organises and selects data and presents them as information to managers is called the Management Information System (MIS).”

In the past, managers were only able to process information on a personal basis, which meant that different managers would operate according to their own different and unique paradigms and perceptions of their environment. Also, systems that were being developed had a functional bias, concentrating exclusively on inventory control, production, accounting or distribution planning.

6.7.1.1 MIS functions

Fortunately, some fundamental changes are now occurring in progressive companies. In the new millennium, management is becoming increasingly system-orientated and more sophisticated in their management techniques. Information is now planned and is made available to managers or other decision-makers as and when needed. This leads to a system that is able to tie planning and control to operational systems of implementation. In today’s leading SCM companies and other logistics organisations, order fulfilment should be the central focus. Every activity should be targeted at supporting this process together with the correct organisational structure and information systems.

Having correct, relevant and timeous information available, is crucially important to the SCM company and its clients. Through the SCM company’s MIS, many customisable reports can be compiled to relay information to their client, regarding amongst others:

- Item stock levels (current stock on hand in the warehouse)
- The monetary value of this stock
- Purchase orders placed (in-coming stock still to be delivered by suppliers)
- Possible work in progress
- Sales orders received (reports are generated by title and by dealer)
- Deliveries executed
- Invoices delivered and paid

Refer to Annexure H at the end of the thesis for examples of some of these reports.

6.7.1.2 MIS development

The basic steps in the development of a MIS (Murdick 1980: 27; McLeod & Schell 2001: 77 – 91), basically consist of three simple processes which follow each other chronologically.

The three steps of MIS development are:

(a) Determining information needs

The determination of information needs is the primary concern in MIS development. The type of information that will be needed by the SCM company to effectively manage its client's account, must initially be decided upon. Just as important, is what information will be needed by the client, in order for him to best manage his outsourced business and have some control over his stock. The SCM company's client is almost never the end-user – they in turn need their stock to be sold-on into the trade.

(b) Determining objectives

Secondly, specific MIS objectives need to be set. Here the SCM company has to decide exactly what its chosen MIS has to be able to do. The relevant important aspects are, amongst others: ease of use, being able to cover a wide range of functions and drafting and printing comprehensive reports, charts and graphs.

(c) Developing the plan

The next step is to develop a specific MIS implementation and execution plan, together with a proposal for management approval. Usually an operational team will develop this plan, which will stipulate all above-mentioned requirements. This plan will then be proposed to the relevant decision-making authorities.

6.7.1.3 MIS advantages

The MIS performs many functions with respect to decision-making. Firstly, it helps managers to make decisions by supplying crucial information that offers guidance in solving problems. Secondly, the MIS aids in the making of repetitive decisions where the decision process remains constant but the input varies. Also, as listed by Fawcett *et al* (1992: 84 - 88), information systems can have the following four additional purposes:

(a) Trigger mechanism

The MIS serves as a trigger mechanism by producing instructions or documents necessary to activate other components of the system. For example, a proportion of the lead-time between a music dealer placing and receiving an order, is accounted for by the length of time that it takes to process the order and initiate picking, packing and delivery by the SCM company.

(b) Control system

Information systems monitor and control the whole system performance, ensuring that established cost and customer service objectives are met.

(c) Coordination

The MIS coordinates functions both within the system and between distribution and other key decision areas of the SCM company.

(d) Integration

Information systems link the SCM company's internal MIS to interrelated external systems such as those of their suppliers, clients and third party distribution operators.

Through further primary research and interviews with supply chain and logistics managers, the following five distinct advantages of implementing an MIS on the SCM company network was identified:

(a) Cross-functional integration

An MIS uses electronic data-capturing mechanisms to calculate the quantities of all items (components, work in progress and finished goods) in the warehouse. This will assist in the reduction of errors because of greater standardisation and better procedures whenever stock is moved, *i.e.* received, issued, picked, invoiced or delivered. In most cases it is easier to achieve technical integration of system areas than it is to integrate across functional boundaries. As a result, information systems provide the prime mechanism to enable cross-functional integration.

(b) Shorter lead times

When items are correctly received when they arrive at the warehouse, the processes that follow (such as order entry, picking and packing) can occur fluently without any unnecessary system hold-ups. This preparation-time improvement will have a positive effect on lead times, customer service and ultimately on the capital budget.

(c) Generating of reports

Charts, graphs and lists can be drawn off the MIS that will reflect quantities on hand, quantities on order and quantities to be delivered. This will directly aid the keeping of a better historical record system. Also, it will improve management's understanding of the business and free their time for higher-level contributions.

(d) Minimum stock holding

The keeping of stock will be down to a minimum when an MIS is used correctly. This will mean that as little as possible capital will have to be tied-up in inventory.

(e) Minimum out-of-stock situations

If avoiding an oversupply were the only problem associated with inventories, the solution would be simple: store fewer items. Unfortunately, not having enough stock is almost worse than having too much stock on hand. In other words, in

conjunction with keeping stock levels to a minimum, an MIS will also help to avoid a stock-out situation and the inevitable resulting loss of orders and poor customer service.

A stock-out occurs when the supply of an item is exhausted and a client has placed an order and expects delivery. Stock-out costs are difficult to determine and often inexact, but nevertheless very real (Johnson and Wood 1996: 316, 319 – 320). Estimating the cost or penalty for a stock-out involves an understanding of client reactions to the SCM company being out of stock at the time the clients want the product. In order to better control this situation, the monetary value of these lost orders must be calculated.

A company's MIS is its heartbeat. All information is entered into it and all reports are drafted from the information entered. Some of the processes which are generated from a MIS are listed and discussed under points 6.7.3 to 6.7.5 below.

6.7.2 SAP supply chain management

Enhancing market position is a fundamental goal for every company interested in staying profitable. *SAP* (the information technology and software development company discussed in Chapter 3 under point 3.2.2) recently developed an MIS system specifically focused on supply chain management companies. The system is called 'mySAP Supply Chain Management', or 'mySAP SCM' in short (www.sap.com/solutions/scm). This system supports the fundamental company goal mentioned above by giving companies a competitive edge that can directly affect market standing. The system will enhance a company's supply chain planning and execution capabilities and will improve all other internal business and operational processes. 'mySAP SCM' claims to be the only complete supply chain solution that empowers businesses to adapt their supply chain processes to an ever-changing competitive environment.

By implementing this or another similar MIS system, a SCM company will be able to offer its clients a value adding service by means of measurable and sustainable

improvements through cost reductions, service-level increases, productivity gains and improved profit margins.

6.7.3 Order processing

The order processing system triggers all other operations in the SCM company's logistics and distribution management function. Whilst in theory it is possible to manufacture, procure or warehouse a product in anticipation of its sale to a client, in practice it is obviously much more profitable and efficient to do so in the certain knowledge of future sales. It is imperative that the moment an order is placed by a client (be it the record company or a dealer in the trade), this event must trigger a string of actions to satisfy that order.

The SCM company needs to receive a formal purchase order from its dealers before any goods can be issued, picked, packed or despatched for physical distribution. When the SCM company receives an order from a music dealer, the first step will be to ensure that there is sufficient items in stock to fulfil this order. If not, more needs to be procured. In a real-time system, entering a specific purchase order into the system will immediately reflect the relevant quantities involved (*e.g.* stock on hand, stock on order and others).

6.7.4 Invoicing

It is important that the quantity and monetary value displayed on the sales order, corresponds directly with the relevant invoice. Many SCM companies generate their invoices from the delivery notes, to ensure that the quantities are correct.

SCM companies invoice on behalf of its clients. This happens because the SCM company delivers directly into the dealer channel, and not first back to its own client, the record company.

6.7.5 Shipment reporting

This report tracks the exact size, value and whereabouts of the record company's stock. This function is especially important because the music titles from one purchase order (placed by the record company on the SCM company to manufacture a certain title) is now being sold into the trade and are travelling in many different consignments to many different locations. If the record company receives a daily or weekly shipment report it will always be fully aware of where its stock is being sold and delivered and how many units are still left in stock in the SCM company's warehouse. Refer to an example of sales reports in Annexure H at the end of the thesis.

6.8 Physical distribution

The establishing, maintaining and enhancing of a company's distribution network, in order to provide a reliable and cost-effective service to its clients, is of utmost importance to the SCM deal. The way in which the final product reaches the market - important aspects are short lead times, good condition and competitive pricing - all hugely influence the success of its introduction into the retail and dealer channel. For most SCM companies, road transport is the only means of transport that is relatively easy to own and operate as part of its in-house own-account sector. Because of the relative shortness of many journeys (as explained earlier in this chapter, SCM companies are often situated very close to its clients and clients' clients), road transport has become the dominant means of transport in many areas of logistics and distribution.

6.8.1 Outsourced distribution

It does, however, happen on some occasions that even the SCM company can not handle all aspects of distribution successfully on its own. This often occurs in peak seasons when orders increase dramatically - this function is then outsourced to companies who specialise in purely physical distribution. This so-called *third party logistics*, where certain elements of logistics are outsourced to third party service providers, is a fast growing trend internationally (Forker 1997: 7). It is also an area of

logistics in South Africa that has seen significant changes in recent times, particularly so in transport and distribution. How information is then traded with these carriers, will directly affect the level of service the SCM company can expect and deliver.

The prime reasons for outsourcing the physical distribution component, is demonstrated by the following five benefits accruing from the use of these specialised, third-party service providers (Franz *et al* 1994: 53; Johnson *et al* 1996: 230; Lynch 2000: 18 – 20; Atkinson 2001: 15 - 18):

(a) Improved customer service

The SCM company can offer an improved service to its clients by utilising the extensive, well-established distribution and service networks of the third-party contractor. Improved levels of service can be achieved especially when servicing clients or markets in out-lying or rural areas, and most particularly when the client does not demand a particularly dedicated service.

(b) Concentrate on core competency

Specialist distribution contractors allow the SCM company increased flexibility regarding its range of services offered to its clients. Specialised management of logistics operations by professional transport and distribution operators release the SCM company's management to concentrate on its other mainstream business activities. Distribution-related problems are left to be dealt with by the contracting company, relieving the SCM company of unwanted pressures.

(c) Reduce costs

The outsourcing of the physical distribution service can greatly reduce costs in the long run. Economies of scale will be realised when a SCM company uses a third-party contractor with an extensive network of services. General distribution of more than one client's goods at the same time, make contractors' operations financially viable and profitable, thereby achieving a more realistic cost for the SCM company's client and ultimately for the end-user. Service

Level Agreements (SLA's) are negotiated in order to meet all requirements and achieve reasonable and competitive bottom-line prices.

(d) Improve management

More efficient management control can be achieved when SCM companies enter into strategic partnerships with third-party providers of distribution services. Contractors usually provide their customers with a weekly, monthly or quarterly report and account (depending on the SLA) for services during that period. Distribution costs are therefore known in advance, enabling the SCM company to budget accurately for the particular service.

(e) Utilising capacity

When the SCM company owns and uses a dedicated fleet, these vehicles are more often than not under-utilised. Even delivery trucks owned and operated by specialist delivery or freight companies, have an under-utilised capacity of between approximately 9% and 11%. On the other hand, research has shown that companies who acquired their own specialised fleet of delivery vehicles, can have an under-utilisation capacity of around 25%, even up to 50% (Forker 1997: 27).

6.8.2 Emergency shipments

When a new release is in production and extensive and successful marketing has been performed for the title, there will probably be a great demand for the item. Music dealers and retailers will place pre-bookings, *i.e.* order the title even before it is ready to be delivered. When the title then finally becomes available, the trade will all expect to receive their orders as soon as possible. The sooner the title is in the shops, the sooner profit-generating sales can begin.

The policy on emergency shipments and the expediting of orders differ between industries. Franz *et al* (1994: 53) calculated that, in the case of emergency shipments, 46% of companies generally outsource the additional capacity required. Some industries

(like the beverage industry in South Africa) do not outsource emergency shipments at all. Since it is the primary goal of SCM companies to offer a value-adding solution through superior service levels to their clients, they often need to employ outside contractors to help them cope with the needed capacity when they suddenly have to expedite emergency shipments.

6.8.3 A competitive advantage

The very nature of logistics and physical distribution, with vehicles on the road facing all kinds of dangers – from hi-jackings to stock losses and delays of various kinds – make it difficult to have what every business needs to be successful: information at its fingertips.

Only recently have local companies been able to track and trace their vehicles and shipments using a combination of hand-held devices like scanners which are coupled to cellular technology (Hoare 2003: 1 – 2). The ability to record electronically when a vehicle leaves a warehouse, know where it is on the road at any given time and see what the various parcels it is transporting contain, with the added capability of updating route-information in real-time, give these businesses a multitude of benefits that will directly impact on the bottom line.

When the SCM company delivers an order to a music dealer in the trade, the barcode attached to the parcel can be scanned immediately and transmitted back to the central system using SMS (short message service) or other cost-effective wireless technology. An invoice can then be printed on-site at the music dealer's premises which will eliminate the cost of recovering information and late payment due to lost delivery notes. Route information is another critical area for concern, particularly when the SCM company owns or operates a large fleet of trucks that has to make many stops on each trip. In a typical delivery scenario a truck driver would receive route instructions that might include a map of the area. Having this on a small mobile computing device with two-way communication capabilities would mean that information could be updated dynamically, more closely allied to the environment in which these vehicles operate.

New route information could take into account additional orders that need to be picked-up or delivered, congested traffic to be avoided thereby removing idle, revenue-losing time, protest marches or other forms of mass action and adverse weather conditions. Customers could be updated dynamically via the World Wide Web as changes occur, giving them an estimated time of arrival and thereby improving service levels.

Management can use the information gathered by the mobile system to enhance efficiencies. Information can be gathered on how long it takes to perform deliveries, how many are made to each area, the exact routes that drivers in fact follow and whether or not routes need to be further optimised due to too many empty miles travelled.

6.9 Debt collection

This value-adding service offered by SCM companies is utilised because the consignment of stock is not delivered back to the primary client (the record company), but rather physically distributed to the appointed music dealers.

The SCM company will execute the sales function and will call on all customers which fall into the record company's target market (*i.e.* music wholesalers, dealers, retailers and others), who will then not place their orders with the record company, but directly with the SCM company. The orders which the SCM company delivers into the trade will include a delivery note and an invoice. It is then up to the SCM company to collect the payments from these dealers, and forward it to their primary client, the record client.

6.9.1 Management of receivables

Refer to the calculation under point 6.10 below for an example of the calculation of the monies that need to be paid over by the SCM company to the record company.

This complex system of financial management by the SCM company provides a central point to monitor, manage and control the financial viability of all assets. The financial

value of the goods are managed by the SCM company's MIS, from procurement right through to the final distribution process.

6.10 Royalty payments

In Chapter 3 under point 3.7 the management of receivables in the current recording industry were discussed (MODEL A). It was explained how the money received from the sale of a single unit has to be divided into many receiving channels. Duties or royalties that need to be paid are:

(a) Ad Valorem

An *Ad Valorem* duty is payable to the South African Receiver of Revenue. Refer to the calculation of this duty in point 3.7.1 which is payable on the manufacturing cost of each music item manufactured.

(b) Mechanical royalty

A mechanical duty or royalty payment has to be made to one of the South African governing bodies, *i.e.* the South African Music Rights Organisation (SAMRO), the South African Recording Rights Association Limited (SARRAL) or the National Organisation for Reproduction Rights in South Africa (NORM). Refer to the discussion on these organisations in Chapter 2 under point 2.3.

(c) Artist royalty

An artist royalty is payable to the artist or band that recorded the album. This payment is calculated as a percentage of the album's selling cost into the trade, also called the PPD (price per dealer). This percentage was negotiated when the artist was signed or contracted to the record company and will be included in the contract between the two parties.

In the MODEL C outsourced SCM model these duties still need to be paid, and it is proposed that the payment thereof remains the responsibility of the record company. If for instance a title is sold into the trade at a PPD of R50.00, the SCM partner company

will collect these monies due from the music dealer and will then subtract the agreed percentage as its service fee, where after the balance will be paid over to the record company.

It is proposed that the SCM company charges a single percentage fee for its combined service offering, but the fee can also be split if the record company is only outsourcing some of its logistical or business activities. If we assume that the PPD of a title to be sold is R50.00, a typical example could be calculated as follows:

Sales fee or commission:	10% of PPD	R5.00
Handling fee:	15% of PPD	<u>R7.50</u>
Total SCM service fee:		<u>R12.50</u> per unit
Payable to record company:		R50.00 – R12.50 = R37.50 per unit sold

The following services are included in the above fees:

- The sales commission includes all aspects related to the management and selling of the product, *i.e.* the cost of employing sales representatives to call on the dealers in the trade, as well as the cost of employing order entry clerks which must capture these sales orders onto the company's MIS
- The handling fee includes all costs related to the handling and physical movement of the stock, *i.e.* warehousing, picking and packing, physical distribution and delivering of the invoice and delivery note or POD (proof of delivery)

Out of the R37.50 that the record company has received for the sale of one of its music CD's, it must therefore pay the three duties or royalties mentioned above, where after the remaining balance will be the record company's gross profit before expenses. Also refer to table 3.1 in Chapter 3 where the breakdown of the unit selling price by the record company is discussed.

6.11 Summary

Most record companies perform many or all of their business processes in-house, even those which are not at all part of their core competencies. Mainly because of a lack of alternatives, record companies have been forced to integrate backward and forward in order to deliver their products into the market.

Managing the logistical and other processes involved in manufacturing, selling and distributing a music title is a complex process that involves all the skills one can expect from experienced managers in the various logistical areas. Keeping an in-house supply of such qualified and effective experts in all fields of logistics management is a very costly task requiring continuous skill-upgrades and industry and best-practise education (Lloyd 2003: 1 – 2). In tight economic times it comes as no surprise that the number of logistical experts in businesses (other than specific logistics companies) are decreasing while their workload is increasing – with the obvious negative effects on quality and customer service.

This study proposes a change in the way in which record companies handle their logistical and other business operations. It is proposed that all non-core business activities, especially those related to their supply chain such as manufacturing, warehousing, inventory management, sales, physical distribution and debt collection be outsourced to a third-party SCM partner. Outsourcing these processes will lead to a huge improvement in quality of work, customer service and ultimately cash flow. The SCM company should be able to add enormous value to the business operations of its record company client. Managers will be free to concentrate on what it is they do best and will not have to worry about the logistics of getting their product to the market.

Woodruff and Gardial (in Mariotti 2002: 91) explain that value is as a customer perceives it, thus the SCM company must find ways to draw out from their clients how they see this value and how it can be added to their businesses – now and in the future. It is concluded in this thesis that the greatest amount of value can be added when all

ANNEXURE

Annexure A: RISA strategic objectives	183
Annexure B: The current RISA membership list	186
Annexure C: A monthly breakdown of South African local sales	190
Annexure D: A breakdown of local and international sales	191
Annexure E: <i>Sonopress SA</i> price list	192
Annexure F: Outlines for a service level agreement	194
Annexure G: The re-ordering model	197
Annexure H: Sales reports	200
Annexure I: Questionnaire to players in the South African recording industry	204
Annexure J: The scope of the SCOR processes	209

(and not only some) of a record company's operation logistical processes are outsourced to a third-party value-adding SCM service provider.

Annexure A: The Recording Industry of South Africa's (RISA) strategic objectives
(www.risa.org.za/risa)

In broad terms, as discussed in Chapter 2 under point 2.5.3, RISA as an organisation is dedicated to improving the state of the South African recording industry and promoting and safeguarding the interests of all member record companies. The following seven detailed services are provided to the South African recording industry:

(a) Lobbying and Representation

- Provide a forum for the discussion of matters of common interest to members
- Promote dialogue between independent creative arms of the industry and address their opportunities, needs and problems, which are ever-changing in the face of modern technology
- Represent the collective views of its members to the public, media, Government Departments and other organisations and persons
- Investigate and support or oppose any legislation or other measures affecting the industry at large

(b) Information and Research Support

- Serve as an information source, continually having available information on the state of the industry, new developments, trends and statistics (refer to the South African music sales figures discussed in Chapter 2 under point 2.7)

(c) Protection and Umbrella Defense

- The protection and enhancement of the rights, including intellectual property rights, of members

- The co-ordination of the industry's anti-piracy activities (discussed in Chapter 3 under point 3.8)

(d) Ethics and Standards

- Establishing and enforcing rules and regulations and a code of conduct for the regulation, maintenance and promotion of standards by members, their management, employees, directors and agents in their dealings with each other and with third parties
- The promotion of ethical business, to repress malpractices and investigate any other illicit activities detrimental to the industry as a whole and to settle disputed points of practice

(e) International Representation

- Establishing and maintaining bonds and reciprocity between the Association and similar associations elsewhere in the world
- Consultation and liaison with related bodies both on an international and national level, including Chambers of Commerce, Trade and Business and other mercantile and industrial bodies for the purpose of joint action in the interests of the industry and commerce

(f) Agency Services

- Entering into contracts as agents on behalf of some or all of its members to promote and advance their interests

(g) Recognition and Awards

- Issuing of awards in recognition of music excellence by artists (refer to the South African Music Awards discussed in Chapter 2 under point 2.4.4)

- Certification of sales achievement by record companies and artists (discussed in Chapter 2 under point 2.5.3)

Annexure B: The current RISA membership list

(www.risa.org.za/members)

A:

ABC Music Productions
African Cream Music
Africa FTW Records
Ahimsa Music CC
Alpheus Music Productions CC
Art of Joy Recording Studio CC
As-Shams Music CC
Azam Khan's Recording Studios

African Dream CC
African Meltdown Records (Pty) Ltd
Afrika Homebrew Entertainment
Aksie 1:8 Musiekbediening
Amanxusa Music Productions CC
Art Music
AV Advertising t/a AVA Studios
A Team Music Production CC

B:

Basia Music Productions
Bethu Music Productions
Big Bee Music Entertainment
Blue Horison Productions CC
Boztor Productions CC
Buddy Electro Music CC

Barapedi Ba Morena Productions
BFD Music Publishers and Marketing
Big Dawg Productions
BMG Records Africa (Pty) Ltd
Bozra Entertainment CC
Bula Music (Pty) Ltd

C:

CCP Record Co. (Pty) Ltd
Chain Records CC
Collaboration Music
CSR

CD's from Heaven
Chissa Records (Pty) Ltd
Colin Records, Music Publishers & Studio
Cube Music

D:

Dagcity Music productions CC
Da Most Records CC
Dasmus Recording and Publication CC
Deiric Walsh
Dotted Line Entertainment CC

Dalom Music Productions and Publishing
Dashmesh International SA (Pty) Ltd
David Gresham Record Co. (Pty) Ltd
Digital Cupboard
Double Gold Music CC

E:

Eastcrew Music Publishers
EZ Music CC

EMI SA (Pty) Ltd

F:

Feel Entertainment
Flashlight Music CC

Fresh Music (Pty) Ltd

G:

Gallo Africa Limited
Ghetto Ruff
Grootboom Music CC
Grass Roots Studio
Grazioso Publishing and Distribution
Green House
GRC

Gia Records
GMI
Gospel Music Advancement CC
Golden Productions
GRM International CC
Groove City CC

H:

Heavy music Production and Records CC
Hit City Records CC

Herbron Ministeries
High Time music Enterprise

I:

IBM Music Productions
Isaac Music Productions
Izingane Zoma Music

Internet Distributors
IPC Records

J:

J and D Recording Studio
JNS Musiek

J.E.V. Records Music Productions
Jostri Music Publishing

K:

Kalawa Records
Khaba Music CC

Kempen Music CC

L:

Lee Thorp Entertainment
Liyana Music
Lovemore Tainments

Legend Music South Africa
Light Masters

M:

Machance Music Productions
Makhoakhoa Music Productions CC
Malekutu Music Productions
Marang Music CC
Matmo Recording Company
MD Music Production
Media Fusion
Mike Fuller Music Records (Pty) Ltd
Mist Records CC
MK Music CC t/a Afrikamusik
Moelamash Productions CC

Macrik Entertainment CC
Magrogen Marketing
Manetrade t/a Fuzzy Records
Maranatha Record Company
Mavuka Productions CC
MDK Records CC
Melodi Music Co.
Milestone Studios CC
Mlozi Records CC
Mob Music (Pty) Ltd
Moloi Chief Workz CC

Mogipa Entertainment CC
Montreal Entertainment CC
Morning Star Music Publishing CC
Mother Groove Records
Music For Pleasure
My Flow Entertainment CC

N:

NC-Links Music Productions
New World Music
Nu Age Music

O:

Onixon Records CC

P:

Password International
Phase 2 Records CC
PS Records
Puncho Richards Music Productions

Q:

Qadi Entertainment Productions

R:

Rampant Records
Red Tomahawk
Rhema Ministries Ancillary
RPM Record Company (Pty) Ltd

S:

Sabsam Music Publishing CC
Sampsongs
Select Music
Seven Words of Jesus Opostolic Church
Sharirisa Music CC
Shifty Records
Skratch Music SA CC
Songo Records CC
Soulman Sol Music
Sovereign Entertainment
Sulushelo Promotions CC
Sting Music (Pty) Ltd

Mo-Nyuku Entertainment (Pty) Ltd
Moribo Music Publishers
Mouse Mix Media CC
MP Tlama Music Productions & Records
Music Time Entertainment CC

New Dimension Music
Nkosinathi Music Recording CC
NW Records CC

Patrick van Blerk Music
Popham Road Studios
Punana Jams Recording & Promotions

Que Records

Readers Digest Association SA (Pty) Ltd
Richie-S Records CC
Risana records CC
Roopanands

Sarepta Music CC
SD Music Productions
Seven Entertainment
Shandel Music
Sheer Sounds
Sizwe Productions
Sollymans Recording Studio
Sony Music Entertainment SA (Pty) Ltd
South Coast Music and Video Productions
Sizoqhubeka Recording Enterprises
S.N.A.B. Music Recording Co. (Pty) Ltd
Sweet Sounds Music Productions CC

T:

Tacc Record Company

Tau Productions CC

Tequila Records

Tlatso Makhetha Music Production

Trio Records (Pty) Ltd

Treasure records CC

TalentLab & Recording Studio

Tetelstai Multi productions (Pty) Ltd

TK Productions

Toboyi Music Publishing

Triple Record Company

Tsop Recording Co.

U:

Universal Music

Uthuli Music CC

Universal Sound & Music Co.

V:

VMP Music

Virgin Records

VKC Music Productions CC

Vision Music

Vuka Back to Africa

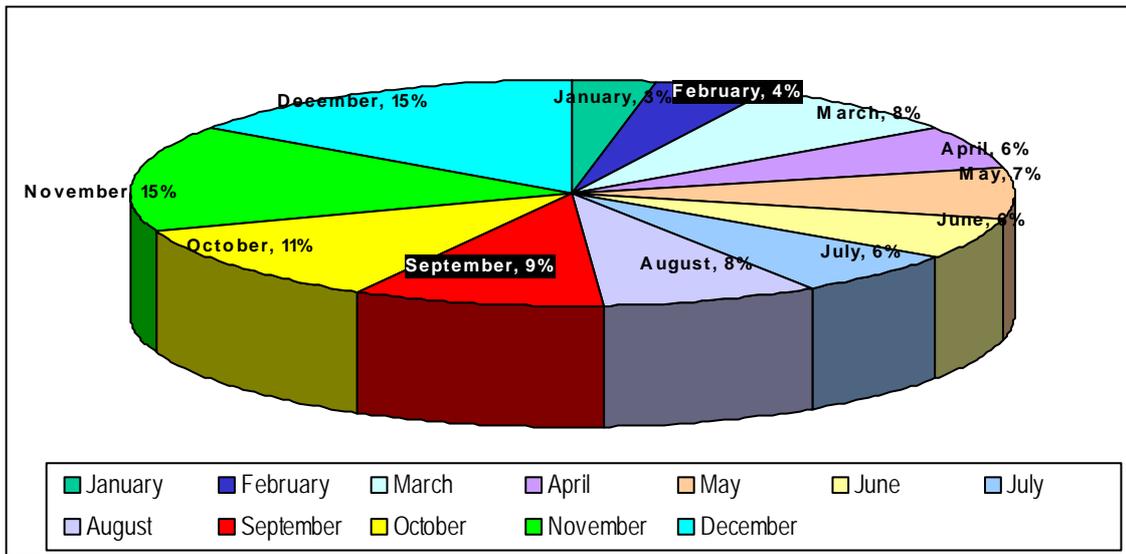
W:

Wolla Music 7 Entertainment

Y:

Y2K Music Production & Entertainment

Annexure C: An average monthly breakdown of South African local sales



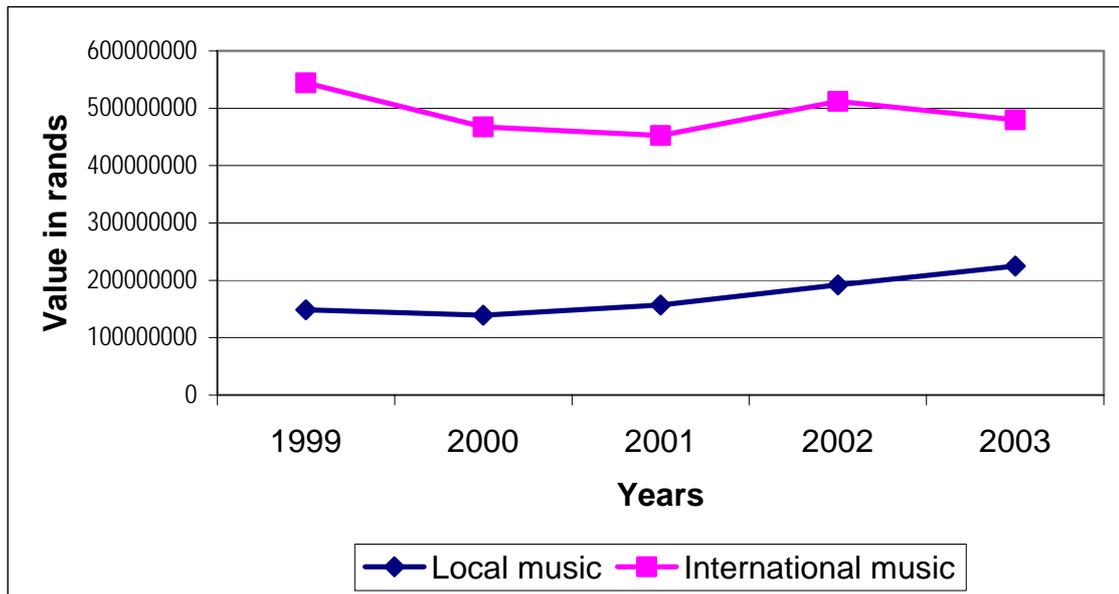
Source: www.risa.org.za

In the pie-chart above, the turn-over of the South African recording industry is broken down into a monthly sales chart, with each slice of the pie depicting one calendar month. The percentages displayed are the average percentages of the sales amounts achieved during the last three years (2001 to 2003).

Note that only sales by local South African artists are included in this chart.

Once again the strong seasonality of the music industry is displayed here. November and December represent 15% each of the total yearly sales of local music. The lowest sales occur in the months of January with 3% and in February with 4% of the sales value.

Annexure D: A breakdown of local and international sales



In the graph above, the line at the top depicts the value of international music sold in South Africa over a five-year period (*i.e.* music performed by non-South Africans). Note the steady *decrease* or decline of international music sold in South Africa.

The bottom line depicts the value of local music sold in South Africa (*i.e.* music performed by South African artists and bands). Note the slight *increase* in the sales value of local music sold.

Annexure E: *Sonopress SA* price list

(www.sonopress.co.za)

Below is listed the criteria and prices of one of South Africa's largest compact disc (CD) manufacturers. The information is divided into three sets which depicts the three main processes of CD manufacturing.

(a) Glass mastering and Matrixing

Prior to compact discs being replicated, the master input medium as supplied by the customer, must first undergo a glass mastering process. The end product of this process is a nickel master, from which 'stampers' or moulds are made using a precision electroforming system. It is from these stampers that the discs are replicated, each an exact copy of the original medium, using an injection moulding process. In order to eliminate costly delays, it is important that all input media conform to specifications. The list of precise specifications is lengthy and can be obtained from *Sonopress* directly.

The cost for the testing and glass mastering is currently R1 550.00, and the cost for the manufacture of the stamper is R260.00 (all prices are excluding VAT). Note that these testing, pre-mastering and glass mastering charges are not charged on single-title orders exceeding 2 000 units per order.

(b) CD replication and CD label printing

The prices listed in the table on the following page are *ex-Sonopress* factory and exclude VAT and any statutory and regulatory levies or duties. Prices are based on replication with a two-colour silkscreen print on the CD - as derived from the customer-supplied artwork. Additional colours, up to a maximum of six, can be added and are charged at an extra R0.15 per colour per disc. The prices listed in the table on the next page are for audio CD's only, according to order size and in rand value.

A varying process set-up charge, at a rate of R75.00 per CD label colour, and irrespective of order size, will also apply. Thus, the process set-up charge for a one-colour CD label is R75.00, two-colour is R150.00, three-colour is R225.00 and so on.

ORDER QUANTITY	UNIT PRICE
less than 250 units	R5.59
250 – 499 units	R4.59
500 – 999 units	R4.10
1 000 – 4 999 units	R3.79
5 000 – 9 999 units	R3.59
10 000 – 24 999 units	R3.39
25 000 – 49 999 units	R3.19
50 000 – 99 999 units	R2.99
100 000 – 249 999 units	R2.79
250 000 – 499 999 units	R2.59
more than 500 000 units	R2.53

(c) Packaging

To the above prices per disc, the following charges must be added as per the customer's specialised and specific packaging needs:

ITEM	UNIT PRICE
Standard jewelcase with black or clear tray	R1.10
Hand-packing of jewelcase	R0.10
Overwrap / shrinkwrap of jewelcase	R0.12
Application of customer-supplied stickers	R0.10

Annexure F: Outlines of a Service Level Agreement (SLA)

A Service Level Agreement is an agreement between the provider of an outsourced service and its principal or customer that quantifies the minimum acceptable service to the latter. The object of the supplier should be to maintain adequate capacity and resources to deliver the agreed performance targets for the required volumes.

Through both primary and secondary research (Rothery and Robertson 1995: 195 – 198), the following five main elements of a SLA were identified. Important aspects or points to consider under each element are also listed:

(a) Identification of service parameters

- Supplier availability (*e.g.* on weekdays, weekends and holidays)
- Turnaround or delivery lead times
- Deadline achievement
- Response time to any requests, queries or problems
- Security (of physical stock and / or intellectual property)
- Meeting the set quality levels
- Unifying the corporate goals of the customer and the outsourced function
- Committing the customer to forecasts
- Deciding on charging rates
- Controlling the impact on the users
- Determining whether the service levels reflect the business objectives and priorities

(b) Quality indicators are useful tools in evaluating the outsourced service. Two examples are listed on the following page:

- A comprehensive year-on-year trend analysis
- Measurements of the attainment of the key service level indicators, *e.g.* the number of objectives committed to and the number of objectives not met

(c) Possible elements in the SLA

- Mission statements by both parties
- Business targets
- Corporate plans
- Business analysis
- System specifications
- Service level specifications
- Service portfolio's
- Capacity plans
- Service level agreements
- Personnel and human resource policies

(d) Regular service level reports will improve the management of the outsource deal. Reports can be drawn-up according to the customer's preferences and specifications and may include information on the following:

- Performance management
- Capacity management
- Security management
- Quality management
- Change management
- Problem management

(e) Making the SLA work

Five control systems have been developed which should all help to make the outsource relationship a success. These systems are listed on the following page:

- Monitor and quantify the achieved service levels versus the set targets
- Hold frequent service review meetings
- Hold frequent customer review meetings
- Include accountability in the supplier's job description
- Introduce frequent supplier staff appraisals

Annexure G: The re-ordering model

The three re-ordering parameters, as explained in Chapter 6 under point 6.3.5 in the thesis, are:

- The amount of units sold during the previous week (a five working day period)
- The amount of stock currently in the warehouse
- The characteristics or status of the title

Re-ordering example and calculation:

In this example, 'Artist ABC' has released a music title called 'MUSIC XYZ' through an independent local record company. 'Artist ABC' has three previous releases and his record company will spend a substantial amount of money on marketing this artist's new title.

The status of this music title (the third parameter above) can thus be calculated as follows (three individual values are awarded for the following three characteristics):

- (d) The status of the releasing artists
This artist has an average local following and will be awarded with a 5, which is an average rating.
- (e) The artist has three previous releases, which is a 3 on the scale.
- (f) The amount of marketing performed:
 - A substantial amount of money has been spent on television, radio and printed advertisements
 - An average amount of marketing collateral has been manufactured (full-colour posters, pamphlets, T-shirts and stickers)

- The artist has received a substantial amount of free publicity from the local press
- The artist has been involved in concerts and tours around the country

The rating on this criteria (marketing performed) will be a 7.

The above three values can thus be tabulated as follows:

(a) Artists status	1	2	3	4	5	6	7	8	9	10
(b) Number of previous releases	1	2	3	4	5	6	7	8	9	10
(c) Marketing performed	1	2	3	4	5	6	7	8	9	10

When the 5, 3 and 7 are added, the total mark is 15. This value is then divided by 3 to obtain the end-value, which is a 5.

A total value of between 1 and 3 will imply a weak or poor status, 4 to 7 will mean an average status and 8 to 10 a high or excellent status. The status multiplication values are:

A status value of between 1 and 3 (weak) implies a multiplication value of 1.

A status value of between 4 and 7 (average) implies a multiplication value of 1.1.

A status value of between 8 and 10 (excellent) implies a multiplication value of 1.2.

To use the re-ordering calculation, the record company must first determine the status of the title (as explained above), then the sales for the last week and the stock on hand in the warehouse. The information for these last two parameters can be obtained from the reports provided by the SCM company.

In this example, it is assumed that:

1. Units sold: 1 500 units in the last week
2. Stock on hand: 760 units on hand in the warehouse
3. Status of the title: a value of 5 was awarded (refer to the calculation above), which means that the title has been awarded with an average status and has a multiplication value of 1.1.

The re-ordering formula is:

Sales - Stock = Re-order amount multiplied by status multiplication value

$$\begin{aligned} 1\ 500 - 760 &= 740 \times 1.1 \\ &= 814 \text{ units to be re-ordered} \end{aligned}$$

The record company will thus re-order 814 units of the title '*MUSIC XYZ*' by the '*ARTIST ABC*'.

Annexure H: Sales reports

The way in which record companies currently manage their business operations (MODEL A), requires that the record company manage all their own logistical processes, including the management of their own stock and sales. The record companies also have to create their own reports which is necessary for any and all future decision making (regarding issues such as stock procurement, repeat orders, operations, marketing, sales and others).

In the proposed outsourced MODEL B, the record company's SCM partner company orders and controls all inventory (including the sales and physical distribution functions). All stock is kept in the warehouses of the SCM company and it is therefore responsible for stock management and control, both physically as well as on the company's Management Information System (refer to the functions of the MIS discussed in Chapter 3 under point 3.2.2 as well as in Chapter 6 under point 6.7.1). The MIS will generate all reports as required by both the SCM company and its record company client.

Two different types of sales reports are shown and discussed on the following page. The two reports contain the following information:

- The 'Sales by title' report alphabetically lists all the music titles of a specific record company. The report then includes the sales figures for each title for the specific periods as required by the record company
- The 'Sales by dealer' report alphabetically lists all music dealers in the trade (*i.e.* wholesalers, retailers, independent stores and others), which are listed as debtors of the SCM company and to which the SCM company sells the music titles of its record company clients. The report then includes the sales figures for all titles per dealer for the specific periods as required by the record company

1. Sales by title report

Title	Artist	To date	Month	6 Months
Part number	Genre	Week	3 Months	Year
Amazing Music	Mister DJ	2887	112	669
CD-2568	Gospel	51	285	1635
Best of the Best	Various	12337	4872	12337
CD-7596	Pop	1532	12337	12337
Choir music	ZZC Church	28755	34	174
CD-2236	Gospel	12	87	351
Favourite songs	The Brothers	2998	2354	2998
CD-9814	Rock	880	2767	2998

Notes, deductions and conclusions on the 'Sales by title' report:

- (a) The first title on the report (CD-2568) was released 18 months ago, but remains a very average seller. The title is probably labelled as a 'catalogue item', which means that it is not a top-seller but has a constant flow of average sales. Manufacturing will continue as long as there are sales reflected. No additional capital will be spent on marketing the title.
- (b) The second title (CD-7596) was released less than six months ago – note that the sales for the three and six month, as well as for the year to date and all time sales are exactly the same. This title has very good sales figures and will probably remain on the record company's top-seller list for a couple more weeks.
- (c) The third title (CD-2236) was release more than five years ago. When looking at the all time sales figure, it is clear to see that this was a very successful title that sold a lot of units. Unfortunately sales for the last year have been very low and production of this title will probably be terminated shortly.
- (d) The fourth title (CD-9814) was released six months ago, note that the six month and all time sales figure are the same. Initially, this title had very poor sales. It

sold only +/- 650 units during the first five months after its release. The record company then marketed this title heavily and the performing artists undertook a nationwide tour. As can be seen in the report above, it was a very successful campaign and sales increased dramatically over the last month.

2. Sales by dealer report

Dealer	Title	Artists	To date	Month	6 Months
Address	Part no.	Genre	Week	3 Months	Year
ABC Music	Best of the Best	Various	258	91	258
Hatfield (Pta)	CD-7596	Pop	36	258	258
ABC Music	Amazing Music	Mister DJ	662	35	190
Hatfield (Pta)	CD-2568	Gospel	11	88	327
ABC Music	Favourite Songs	The Brothers	98	31	98
Hatfield (Pta)	CD-9814	Rock	21	43	98
Best Records	Favourite Songs	The Brothers	46	33	46
Hillbrow (Jhb)	CD-9814	Rock	17	39	46
Best Records	Best of the Best	Various	241	85	241
Hillbrow (Jhb)	CD-7596	Pop	27	241	241
Best Records	Amazing Music	Mister DJ	545	26	180
Hillbrow (Jhb)	CD-2568	Gospel	8	71	463

Notes on Sales by dealer report:

- (a) Stores are listed alphabetically. Titles are listed according to the amount of units sold over the last week, with the title with the highest sales value listed first.
- (b) *ABC Music* in Hatfield, Pretoria is an average-sized independent music store. The students at the University of Pretoria are their main target market. Note that their biggest seller for the last week has been a pop album. They have also sold some gospel and rock music.

- (c) *Best Records* in Hillbrow, Johannesburg, is a music wholesaler. They buy stock directly from the record company and then sell it on to smaller independent stores. They generally stock all types of music.

Annexure I: Questionnaire to players in the South African recording industry (*i.e.* local record companies, their clients and suppliers)

Note: Respondents were handed the Questionnaire and asked to complete their answers on a separate piece of supplied paper. Afterwards, their answers to the questions were discussed and a further interview followed if necessary.

(a) Personal profile

1. Name of person being interviewed?
2. Please elaborate on your job description and list your functions and responsibilities within the company.
3. How many years have you been employed by the company and how many years have you spent in your current position?

(b) Company profile

1. What is the full registered name of the company where you are employed?
2. What type of company is it / what is the company's main business function? (*e.g.* a record company, music dealer, supplier, supply chain management company or other)

3. What is the nature of the business / type of product and product characteristics? (*e.g.* managing artists, buying and selling music, manufacturing compact discs or other)

4. Company characteristics:
 - How many offices do your company have? (both in South Africa and internationally)
 - What is your distribution area? (*e.g.* regional, national or international)
 - How many client companies / debtors do you have? (*i.e.* customers)
 - What is the number of employees in your company?

5. Annual sales figures: (*not compulsory*)
 - If applicable, what is the volume sold (*i.e.* unit quantity)
 - What is the company's yearly turnover (*i.e.* rand value)

6. Assessment of potential internal company strengths:
 - What are the company's core competencies in key areas?
 - Does the company possess adequate financial resources?
 - Is the company perceived to be a potential market leader?
 - Does the company have access to economies of scale?
 - Is the company insulated from strong competitive pressures?
 - Does the company own proprietary technology?
 - Does the company have any cost advantages? If so, what are they?
 - Does the company have any product innovation skills?
 - Does the company have a proven management team?

(c) Industry profile

1. What is the overall size of the market in which your company is operating?
2. Scope of competitive rivalry:
 - Describe the competitive rivalry amongst competing sellers (other record companies or other music dealers).
 - Is there a threat of potential new entries into the relevant market?
 - Is there competition from substitutes? (*i.e.* titles released by competitors)
 - What is the perceived power of your suppliers?
 - What is the perceived power of your customers?
3. What is the relevant market growth rate? (annual percentage)
4. At what stage of its life cycle is the industry? (new / mature / declining etcetera)
5. How many companies in South African are operational in this industry?
6. How many major customers are there in the industry? (number of buyers)
7. What is the perceived ease of entry and exit into the industry?
8. What are the current and relevant experience curve effects?
9. What are the dominant economic characteristics of the industry environment? (*e.g.* industry structure, capital requirements, scale economies and others)
10. What is the industry's perceived long and short term profitability?

11. What are the main driving forces in the industry?

12. What are the important key success factors in the industry?

13. Are there any new industry prospects and what is the overall attractiveness of the industry?

14. Potential external opportunities:

- What is the company's ability to expand into new markets or segments?
- What is the company's ability to transfer skills or technological know-how?
- Is the company currently integrated forward or backward? If so, please supply details.
- Could the company enter new foreign markets?
- Could the company make use of new and / or improved technologies?

15. Potential external threats

- Is there the possibility of entry of lower-cost foreign competitors?
- Is there a rising in the sales of substitute products?
- Is there an adverse shift in foreign exchange rates?
- Are there any detrimental regulatory requirements?
- Are any new technologies threatening the company or industry?

(d) Processes (if any) outsourced to value-adding third-party supply chain management service providers (relevant to record companies only):

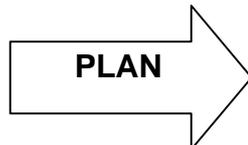
- Are any business activities outsourced to third parties? (*e.g.* procurement, warehousing, physical distribution, sales, order entry, reporting, debt collection or other). If so, please supply details.
- Does the company have any Service Level Agreements in place? If so, please supply details on the nature of contracts, time frames etcetera.
- If relevant, please elaborate on the management of the outsourcing process at all levels.

Annexure J: The scope of the SCOR processes

(www.supply-chain.org)

The five processes of the Supply Chain Operations model (SCOR) are listed below:

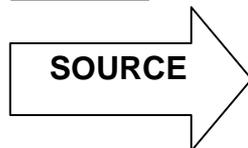
Process 1:



Demand / Supply planning and management

- balance resources with requirements and establish / communicate plans for the whole supply chain
- manage business rules, supply chain performance, data collection, inventory, capital assets, transportation, planning configuration and regulatory requirements and compliance
- align the supply chain unit plan with the financial plan

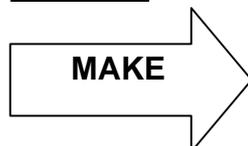
Process 2:



Sourcing stocked, made-to-order and engineer-to-order product

- schedule deliveries, receive, verify and transfer product and authorise supplier payments
- identify and select supply sources when not predetermined
- manage business rules, asses supplier performance and maintain data
- manage inventory, capital assets, incoming product, supplier network, import / export requirements and supplier agreements

Process 3:



Make-to-stock, make-to-order and engineer-to-order product execution

- schedule production activities, issue product, produce and test, package, stage product and release product to deliver
- manage rules, performance, data, work-in-progress, equipment and facilities, transportation, production network and regulatory compliance for product

Process 4:



Order, warehouse, transportation and installation management for stocked, made-to-order, engineer-to-order and retail product

- all order management steps from processing customer inquiries and quotes to routing shipment and selecting carriers
- warehouse management from receiving and picking product to load and ship product
- receive and verify product at customer site and install, if necessary
- invoicing customer
- manage business rules, performance, information, finished product inventories, capital assets, transportation, product life cycle and import / export requirements

Process 5:



Return of raw materials (to supplier) and receipt of returns of finished goods (from customer), including defective, MRO and excess products

- all return of defective product steps from authorising return, scheduling product return, receiving, verifying and disposition of defective product as well as return placement or credit
- return excess product including identifying excess inventory, scheduling shipment, receiving returns, approving request authorisation, receiving excess product, verifying excess and recover and disposition of excess product
- manage return business rules, performance, data collection, return inventory, capital assets, transportation, network configuration and regulatory requirements and compliance

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