Challenging THE STATUS QUO

By Stephen Maister

South Africa has moved into a new supply chain era. The distribution centre (DC) model has become the dominant standard and direct store deliveries (DSD) by suppliers, or their third party logistics service providers are declining. Still, the business processes and the material handling around it – from factory gate to DC and over the last 50 metres to the store, are wide open for radical improvement. The real cost-savings and efficiencies to be gained from a modern supply chain in South Africa are still to come.

In fact, some believe that there is as much as another 10% in cost savings to be won. Another view is that a Tesco arrival in South Africa would see them retail at around Pick n Pay's cost price.

What we're looking at is the potential for retailers to make huge cost savings. Savings that can go straight to the bottom line or be put into price. Savings that will give the retailer that first leverage these opportunities provide to gain huge competitive advantage.

Cost-to-shelf, for example, was, in the past, not the retailer's problem or opportunity. Neither was it the supplier's – they had fixed cost distribution, sales and merchandising agreements with their third party agents. Distribution efficiency was not part of supplier/retailer negotiations. Now it is and it is moving beyond DC allowances to exploit other areas of distribution efficiency. There are new areas where retailers are beginning to take responsibility and earn cost savings for supply chain functions previously provided by suppliers. These include merchandising and the true costs of 'Full Stock Responsibility' clauses in supplier trading term agreements.

These piecemeal changes to the status quo seem set to continue. Radical change, on the other hand, is constrained by limitations to retailer DC capacity, continued reliance on suppliers for sales and distribution services, failure to make automated ordering work and the continued reliance by retailers on supplier merchandisers in-store. At the same time, suppliers, no doubt, take comfort in this dependency, as their sales people and merchandisers give them continued control over their destiny in-store.

An alternative scenario

However, there is an alternative scenario that could threaten this slow change in the way retailers and suppliers negotiate with one another. What would happen if a foreign player came to town? A Tesco, a Wal-Mart or an Aldi? Their game changing tactics would go like this. "Here's the addresses of our three DC's – now what's your best price? No, we don't want your sales people, or your merchandisers in our stores. No we'll take responsibility for the stock. Don't talk to us about incentive rebates and co-op ad spend. Just give us your best price. And while you are about it – give us your factory gate price, we may want to pick up the goods ourselves."

If they don't like the prices they're offered, well these large-scale international players can fall back on their global supply chain networks to get the goods at prices that will work for them.

The estimate is that there is about a 20% difference between current supplier South African prices and their export price. This is accounted for by the costs they incur in selling merchandise on the local market and which they avoid in export sales. These include the costs of physical distribution, field sales and merchandising services on the one hand and the costs of the trading terms agreements which comprise of incentive rebates, settlement discounts, co-op and promo ad allowances, cost of special display, the costs of Full Stock Responsibility, listing fees and everything else retailers use to extract more in their negotiations with suppliers.

Cutting out the middle man

What retailers have learnt, or are beginning to realise, is that not only can they do many of these things that suppliers have been doing for them a lot cheaper and more efficiently themselves, but that there are additional cost benefits and efficiencies that are by-products of doing so. For example, not only does DC distribution reduce total transport and handling costs in getting goods to the stores, but there are a host of other benefits in doing so. These include a greatly reduced stock room space requirement in the stores, lower back door security and admin costs, reduced shrinkage, reduced days' stock in store, and a greatly improved ability to manage and

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reduce out-of-stocks. With international experience saying that every 1% out-of-stock reduces store sales by 3%, this alone is a huge incentive to introduce DCs.

Shoprite's 5% net margin before tax in its most recent results compared to traditional corporate supermarket chain earnings around the 2-3% area is a clear indication of the profitability of the typical 4-5% DC allowance that suppliers allow retailers on sales to DCs and the other attendant savings from DC distribution.

Merchandising allowances and the last 50 metres

The next bite at the 20% difference between full service local prices and export prices looks to be merchandising allowances.

The provision of supplier merchandisers in-store goes back to the days before planograms dictated shelf space. Merchandisers were able to effectively steal shelf space from competitors and gain market share from their less active competitors. Though less effective in this role in today's retail environment, they continue to ensure that the suppliers product is on-shelf and this gives them some control over their destiny in-store.

While retailers have viewed supplier merchandisers as free labour, they are terribly inefficient from an in-store logistics or goods handling point of view. They are also often the cause of shrinkage and disruption with the store's own staff. There is perhaps one major blessing of supplier merchandisers that will make it hard for many retailers to dispense with their services – that's the back-up they provide when the store's staff goes on strike.

A 'one touch' system

Compare the way merchandisers and store shelf packers work in-store today with this scenario: The store's order for shelf stock is delivered by the DC in rolltainers. The stock is packed in the rolltainer in shelf order sequence. So, the first item to hand at the top of the rolltainer is the first item on the gondola run that has been ordered. The next item to hand is for the next product on the shelf to be replenished, so the shelf packer can work down the aisle with minimum effort. This is the logistics ideal of 'one touch' handling in action. Any case or shrink is handled just once all the way from the DC to its final position on shelf.

There's no supplier or store merchandiser, going to the stock room, scratching around to find just his brands for the section he is working on, extricating them from the deliveries, or taking them from where they have been stacked, then loading them on to a stock trolley and handling them again in the aisle. These rolltainer deliveries are consolidated orders of all brands sequenced in shelf order. While highly efficient and drastically reducing the total man hours required to stock the shelves, the way it works makes dedicated supplier merchandisers looking after their specific brands an anachronism.

The fact is that retailers can do the job a lot cheaper. So, its interesting to hear that Shoprite is investing in rolltainers and are asking suppliers for a 5% merchandising allowance in place of providing them with in-store merchandisers. Pick n Pay is also investing in rolltainers but sees a somewhat longer time frame for implementing a true 'one touch' system. They first have to standardise their store shelf order sequence and align their DC with this.

The system is not new to South Africa. Spar had it working in the 1980s and it proved a huge boon to its members. Problems with managing the return of the rolltainers from the stores were one of the reasons for them to abandon the system. Another might have been optimising the use of the cube in their trucks (especially when restrictions on the maximum delivery distance by trucks were lifted), which then favoured deliveries on pallets.

However, redesign of rolltainers and their delivery trucks is said to have improved their use of truck space and minimise the advantage of pallet deliveries. Another plus claimed for rolltainers is that they offload faster than pallets, speeding up delivery truck turnaround.

Full stock responsibility

The move to DC distribution vastly reduces the number of invoices and delivery notes that pass between suppliers and stores. Full Stock Responsibility clauses in retailer/supplier trading term agreements are ▶

CASE STUDY: Malelane Superspar

Early morning 26 January 2010, the day after pay day. "The store looks like a million dollars," says Superspar Malelane owner, Lex Hollmann. No special preparation was done for the photo. The one gap on shelf is an out-of-stock – they do not dummy pack over the gaps.

Lex Hollmann's Malelane Superspar was under growing pressure. Despite its 6 000 m^2 gross area and super wide aisles, their store volumes had grown, especially at month end, to the point that merchandising was interfering with shopping. Not surprising with a store that had grown to 200 000 customer transactions a month.

In particular, they found that their KVI's were under pressure – especially as their month end trade was spiking higher and higher. While they had adjusted shelf space and ordering in part to accommodate the month end trend in their sales, it was not enough. Their solution was to replace daytime merchandising with night merchandising.

They now work with a team of ten night merchandisers. Initially there was some reluctance on the part of staff to do night merchandising. They negotiated with them and the night team gets a special night merchandising allowance and they also pay taxi fares as the staff have to make it home against the commuting flow.

Night merchandising is done every night of the week including weekends. The team starts at 8pm when the store closes and is locked in the store until 5am when the store opens for the early staff. Team safety is insured through emergency exits which are burglar alarmed and CCTV camera surveillance.

Says Lex Hollmann, "Every morning at 5am, the store looks like a million dollars – I can take a perfect picture any morning I walk in – the store just looks fantastic!"

Stock is received and checked during the day and it is all ready for the night team when they start at 8pm. Unhindered by customers and other staff, shelf packing productivity has more than doubled.

Previously there were 30 supplier merchandisers working in the store. These have been reduced to around 15. Supplier merchandisers have always been a problem, notes Lex. They were always involved when it comes to shrinkage problems and they do not have the interest of the store at heart and manage to irritate store staff who do. So they are often the cause of staff unhappiness. All of which has made Lex happy to see their numbers reduced.

One of the things the night team also does is to check and report missing shelf-edge labels which are then replaced during the day. Those merchandisers that remain do spot fill-in merchandising during the day and some work full time on really high volume categories such as Coke and dairy. At the same time, the move to night merchandising has enabled Superspar Malelane to reduce the number of store merchandisers by three or four.

In the move to night stocking, Lex sought merchandising allowances from suppliers. Some came to the party, others did not. Another benefit of night stocking is that it makes ordering more efficient. During the day, you are often not sure if the stock is on the way but in night stocking, it either arrived or not.

But the biggest plus for night stocking is increased sales. Lex attributes part of their sharp increase in month-end sales, not just to a shift in customer buying patterns but also to the fact the store is always fully stocked, especially for early morning.

All around it has proved a real win for this busy store. Lex does not know whether it will be worthwhile to go for night stocking in lower volume stores where it is easier to merchandise during the day, but it certainly works for Malelane Superspar.

another anachronism left over from a past trading era. They create a huge amount of costly paperwork in passing credit notes and reconciling statements. Picking up the returned stock is also problematic and costly for suppliers who no longer deliver direct to the store.

The original intention of these clauses was to put the responsibility of sales representatives who overloaded stores with stock back onto suppliers, enabling stores to return excess stock. Modern stock control and ordering systems as well as the introduction of DCs and ordering on them by the store and not by the sales representative has largely eliminated the original abuse by supplier sales people.

Its existence, however, encourages poor merchandise handling in-store, which leads to damaged goods and sloppy ordering. It remains a convenient way for store operators to reduce stock holding for stock takes and manage cash flow problems that pass between suppliers and stores.

What it does is create huge waste and costs for suppliers which all gets factored back into their list prices. It is something that six of the largest suppliers are reported to have eliminated in their trading term agreements with retailers., replacing it with a reported half percent swell allowance.

Initially the provision of sales and merchandising services, store deliveries and all the allowances and rebates were given on a more reactive ad hoc basis. This favoured the larger and more aggressive negotiators. The result was that some retailers were, in effect, subsidising their more powerful and aggressive competitors.

More challenges and opportunities

To fully exploit the opportunities to cut costs and improve margins that a modern DC-based supply chain offers, there is a lot more that both retailers and suppliers need to change and adapt.

For example, the way suppliers arrive at their list price and the way they then negotiate allowances must already be under huge pressure. And this will continue as retailers transition and seek to exploit cost savings in the supply chain.

Historically, suppliers calculated their list prices by putting all their costs of production, sales, merchandising and distribution plus the other costs occasioned by trading term agreements and their desired gross into one pot to generate an average price as their list price.

There is a lot of evidence that there is no longer such a big difference and that suppliers have become far more proactive and professional in managing many of these costs and that they are allocating 'trade spend' far more strategically, matching their products and 'trade send' with store customer profiles and monitoring the results of their spend far more closely.

However, the different rates of supply chain development among retailers and greater complexity is creating a need for a different approach to pricing, what some refer to as menu pricing. This would give a factory gate price, a price delivered to a DC, a price delivered direct to store, a price with sales service, and a price with merchandising services.

Incentive rebates, one of the key trading term items for retailers, have also proved to be a double-edged sword with a number of adverse consequences. As retailers pushed for bigger and bigger incentive rebates they also became more and more dependent on their bigger suppliers and achieving their incentive targets. This resulted in prejudice to smaller competitors in the market place.

Lack of competition

One result is that South Africa does not have a strong secondary supplier industry. This lack of competition from powerful secondary brands has resulted in, among other things, a much lower stock fill rate. In Europe, where strong number twos are in more plentiful supply, suppliers are far more careful about maintaining an in-stock position and not leaving a gap for these secondary competitors to jump in.

The estimate for South Africa is that for every 100 cases ordered by a DC only 88 are delivered. This is an improvement on what it was a few years ago but still compares poorly to the international standard that is 95%. A 95% fill rate would, through careful management and liaison with suppliers enable DCs to give their stores 99% of the stock they ordered. This is a huge advantage as it is estimated that stores lose 35% of sales for every 1% of out-of-stocks.

Buyer incentive

Attention to the way buyers are incentivised will improve overall performance in the new supply chain era. Too much of buyer incentive packages, it is claimed, focuses on co-op advertising, display allowances and listing fees, while gross margin and sales percentage contribution do not get the attention they deserve. Also, it is claimed that buyers are spending too much time and effort to set the lowest price on promo items, yet promo items form a small percentage of total DC withdrawals. More effort, it is argued should be applied to category management to drive category sales.

It is also argued that secondary brands would do a lot better with a change in the way buyers are rewarded. Secondary brands offer low, low prices and good margins. This is not good for buyers as long as they don't get measured much on GP and do better on rebates, co-op and listing fees.

Revolution versus evolution

While retailers are piecemeal changing the way they do business with suppliers, there are voices that suggest revolution will bring a far bigger return than gradual evolution. And, that the first mover will gain a huge competitive advantage.

For example, retailers, it is argued, would be better off if they got the export price and no co-op ad spend. This would give them complete freedom to advertise and promote those products that would bring more feet into their stores.

The supply chain efficiency race is really on. Independents, franchise store operators, franchise and corporate groups are working through all the elements to make themselves more efficient and more competitive in a trading environment that is set to change.

One thing that does not appear to have changed is the position and role of the supply chain in retail organisations. Supply chain, it is argued, cannot remain an almost separate group service. It is central to the future of the business.

To maximise the opportunity presented by modern supply chains, they say the position of the top supply chain person in retail organisations also needs to reflect this. The top supply chain person in retail organisations needs to be the group supply chain director and should have no less a rank than the deputy CEO.