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RETAILER-SUPPLIER COLLABORATION IN THE SUPPLY CHAIN

LESSONS FROM PRIVATE-LABEL RELATIONSHIPS

By Pierre Mercier and Stuart Battle

The idea of increasing collaboration between retailers and suppliers is not new, and most agree that working together is a good thing. The benefits can be substantial: successful collaboration efforts typically reduce inventory throughout the supply chain, lessen its environmental impact, and eliminate 2 to 3 percent of total end-to-end costs.

According to recent industry reports, approximately 80 percent of retailers and suppliers believe that collaboration has grown in the past three years. Despite this growth, however, the practice is not widespread, and the benefits achieved are often incremental rather than transformational. As a result, it's still not unusual to find duplicate inventory holdings within the same network, underused truck fleets, backlogs of fast-moving stock languishing in retailer warehouses, and low on-shelf availability of some products—especially promotional items.

According to analysis by The Boston Consulting Group, moving products from factories to shelves is a costly part of the total value chain, representing 9 to 17 percent of end-to-end costs. Collaboration efforts aim to reduce those costs and streamline inventory through better forecasting, faster order fulfillment, the use of joint warehouses or consolidation centers, and practices such as backhauling, which involves picking up goods from suppliers on return trips after making deliveries to stores.

The unfortunate reality is that even today's most mature markets have margin-sapping inefficiencies across their supply chains. Inventory levels are far higher than they need to be, and more than 80 percent of retailers' trucks still return empty after making store deliveries. Too often, collaboration efforts lose momentum when suppliers insist on maintaining control of the supply chain, or retailers and suppliers independently forecast demand instead of sharing real-time data. In those situations, collaboration fails to deliver the promised results.

The experience of a major European retailer is typical. Several years ago, the company planned to establish flow-through operations for its grocery items to minimize inventory levels, maintain fresher stock on shelves, and reduce operating costs. To enable daily deliveries to its distribution centers without increasing inbound costs, the retailer encouraged suppliers to set up joint warehouses to consolidate merchandise. The initiative soon ran into problems, however. Some suppliers resisted the changes because they felt that joint warehouses were unnecessary and had a negative impact on their distribution costs. Operating with no inventory buffer in its distribution centers and hampered by unreliable service from suppliers, the retailer had a difficult time maintaining sufficient on-shelf availability. Now, almost 10 years later, less than 15 percent of the retailer's grocery volume is handled as flow through.

Obstacles to Effective Collaboration

The problem is that collaboration efforts run into many real challenges, both internal and external. In retail and supplier organizations alike, merchandising and supply-chain functions can operate at cross-purposes, with misaligned goals and incentives compounded by a lack of communication. Without senior sponsorship and information sharing, collaboration initiatives are unlikely to succeed—especially since it can take years to build solid relationships and because short-term priorities on both sides change continually.

Complicating matters even further is the inherent mistrust that commonly exists between retailers and suppliers, which can keep them from working together more effectively. Many times, an imbalance of power allows retailers to offload inventory and logistics costs to suppliers by requiring shorter lead times for orders and more frequent deliveries. Suppliers then try to recoup those added costs during price negotiations. Moreover, retailers have no way of knowing whether the process improvements that they set up with their suppliers will then be shared with competing retailers.

Retailers and suppliers have also become direct competitors. Retailers' private labels compete with suppliers' branded products, and suppliers have begun exploring alternative channels, such as discounters, online sales, and other direct-to-consumer channels, bypassing traditional grocery retailers.

The picture can be very different for private-label suppliers that make products exclusively for retailers. In these partnerships, the risk that the benefits of collaboration will be shared with competing retailers is not usually an issue. Since joint interests are more closely aligned, these collaborations tend to be more effective. Despite the differing dynamics, the lessons drawn from how they work together can help retailers and suppliers of branded products to collaborate more effectively and achieve far better results.

The Private-Label Difference

Suppliers of branded products must cater to the needs of many retailers, whose lead times, minimum order quantities, delivery cut-off times, and packaging requirements are often very different. With no single, dominant customer, the suppliers must optimize their operations while accommodating all of these parameters. In contrast, private-label manufacturers deal with fewer variables. They often have exclusive relationships with retailers, and must only meet the wants and needs of these core customers.

The exclusive nature of their relationship helps private-label manufacturers and retailers achieve true integration and collaboration more easily. As a result, they often share assets as well as information. For instance, a manufacturer may deliver directly to a retailer's consolidation centers to avoid the cost of owning and maintaining its own warehouses. Or, the manufacturer might share the retailer's distribution fleets, which also simplifies logistics and reduces costs.

What's more, the collaboration within these relationships doesn't end at the supply-chain interface. Rather, the parties seek to align operations in mutually beneficial ways. For instance, they may develop joint operating practices to capitalize on the retailer's forecasting ability, order and replenish merchandise in a way that optimizes the manufacturer's production schedules and batch sizes, or work together to minimize waste and inventory levels without sacrificing product availability and freshness.

Through a series of collaborative initiatives such as these, a U.K.-based retailer was able to eliminate 2 percent of end-to-end value chain costs. Key aspects of the collaboration included joint purchasing of raw materials so the supplier could leverage the retailer's purchasing clout, rethinking product recipes and packaging to lengthen shelf life and increase transport efficiency, and greater visibility into demand and inventory levels to optimize manufacturing and delivery processes. By openly sharing operating costs and cost drivers, the retailer and supplier were able to identify areas with the greatest potential for savings. For instance, many costs stemmed from demands—such as accommodating last-minute orders and making daily deliveries of small quantities—that the retailer made of its supplier. By improving planning and information sharing, aligning the retailer's orders with the supplier's production schedule, and challenging long-held beliefs, many of those costs became avoidable. Work practices changed, on-shelf availability improved, and the savings were shared by both parties.

Because retailers and private-label suppliers find it easier to align their goals and objectives, they tend to be willing to engage at strategic and tactical levels and to share their information more openly. This transparency, in turn, helps to reveal excess costs, inefficiencies, and poor trade-offs among availability, cost, inventory, and waste in the end-to-end process—which leads to better decision making. Moreover, since the relationships are usually exclusive, retailers worry less that their competitors will also benefit from the new ways of operating.

Furthermore, collaboration between retailers and private-label manufacturers remains driven by necessity. Because manufacturers' margins tend to be thin on private-label products, costs must be squeezed from the supply chain wherever possible if the retailer wants to see a lower overall cost. This same cost incentive should encourage collaboration between retailers and suppliers of branded products as well.

Applying the Lessons

Successful collaborative relationships between retailers and suppliers require a considerable investment of time and other resources. That's why the sponsorship and commitment of senior-level executives from both parties is critical, to ensure strategic alignment, define the boundaries of the partnership, provide an escalation route for quickly resolving differences, and maintain momentum through the inevitable hard times. Other key factors include the following.

- *Choose collaboration partners carefully.* Start by focusing limited resources on a few deep relationships with the greatest potential for cost savings. As initial benefits flow in and capacity becomes available, grow the number of relationships over time by bringing on new suppliers in waves.

- *Make a long-term commitment.* Collaborative relationships must be multiyear commitments to survive the inevitable ups and downs and to justify the time and investment they require. Defining principles and processes in advance will pay off in the long term.

- *Agree on how to share benefits.* Upfront agreement on how to share benefits will help prevent initiatives from running into trouble—particularly if benefits are unevenly distributed or an investment by one of the parties is required.

- *Build cross-functional teams.* Cross-functional teams are vital if the real sources of waste and opportunity are to be identified, but make sure that clear ownership exists for delivering results.

- *Turn successful pilots into business as usual.* Many companies stop once they achieve initial pilot success. Instead, reapply relevant learnings and best practices to generate ongoing improvements. Benefits continue to accrue when pilots become business as usual.

- *Sustain top-to-top alignment.* Senior-level sponsorship from both parties must be aligned at the outset and reconfirmed on an ongoing basis. Hold annual or biannual meetings to measure progress and address any roadblocks. Be sure to track progress and results by establishing clear metrics for measuring performance improvements and cost savings. Maintain momentum by continually tracking and reporting results.

Effective collaboration is challenging even under the best of circumstances, but these success factors can help build and deepen the relationship between retailers and their suppliers. A final caveat: Before moving forward, make sure to evaluate your own organization's readiness to cooperate, commit the long-term resources you'll need, and make the necessary trade-offs. For most industry players, the payoff is well worth the investment. The supplier-retailer interface is a major source of untapped value that can be released through greater openness and partnership. And the results may transform the bottom line.

About the Authors

Pierre Mercier is a partner and managing director, and **Stuart Battle** is a project leader; both are in the London office of The Boston Consulting Group. You may contact them by e-mail at mercier.pierre@bcg.com and battle.stuart@bcg.com, respectively.