Retail DNA

Unlocking the Secrets of Supply Chain Excellence

The 2005 Logistics Study for
the Retail Industry Leaders Association

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RETAIL INDUSTRY LEADERS ASSOCIATION

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Introduction

The Retail Industry Leaders Association (RILA) and Kurt Salmon Associates (KSA) are pleased to present the 2005 RILA Logistics Study.

Retail organizations assemble key operating ingredients of strategies, processes, tools, and relationships in different ways. Small and large, general and specialty players look different to consumers, and in some respects, operate their businesses differently. Yet there are many common underlying principles that drive these organizations to similar levels of success.

This year's study is an ambitious effort to identify how seemingly diverse organizations assemble key business elements in different ways to drive success in their companies. Which elements are common and universal across these diverse businesses, and which are different? The goal is to understand the "core DNA" for various businesses, and what it suggests about business drivers.

Input was obtained through direct conversations with senior retail and supply executives from a broad range of formats including mass retail general merchandisers, specialty retailers, grocers, office supply retailers, and also covered direct to consumer business as part of a combined retail offering. We asked what was going on in businesses today, what they were working on, and what they thought the future would hold. Their comments are included in this summary.

This project was conducted with the support and guidance of the RILA Logistics Steering Committee:

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Sandra L. Kennedy, President

Background

We've arrived at a watershed moment where many key advances, which will serve the industry over the next decade, have either been developed or are nearing development.

It was more than 50 years ago that Drs. James Watson and Francis Crick discovered the structure of DNA. For many years prior to this Nobel Prize-winning achievement, scientists had been aware of the four key chemicals that represented the building blocks of human genetics, but struggled to identify the unifying influence of the double helix.

With Watson and Crick's discovery, modern genetic science had finally assembled all of the tools required to completely map the human genome. And yet, for 40 years little progress was made in establishing how these building blocks truly interacted to cause each of us, who are similar in many respects, to be uniquely individual. While the building blocks and structure have been known since Watson and Crick, only recently have new discoveries brought us closer to understanding how this comes together to define our reason for being!

The consumer supply chain finds itself in much the same position today as the scientific community of 1954. We've arrived at a watershed moment where many key advances, which will serve the industry over the next decade, have either been developed or are nearing development. What remains to be completed is the monumental task of combining the right elements to create a comprehensive set of capabilities that will provide the solid foundation for dramatically improved supply chain operations for individual companies.

While the companies that have pioneered rapid accomplishments in supply chain operations over the past five years have enjoyed some early benefits, for the most part, those on the sidelines have not yet been permanently harmed.

Those days are over!

As the pioneers begin to realize the incredible power of combining individual elements to create their own version of a comprehensive "supply chain genome," the competitive advantages will drive out many of the followers.

A Sea of Change is Coming

Just think of the dizzying array of changes and advances that have developed in the past few years alone. A decade ago, we were discussing when companies were going to begin using advance shipping notices (ASNs), less than half of merchandise handled through retail distribution centers (DCs) was floor ready, bar codes were still gaining broad use, and "people issues" were a key concern. Retail logistics for most organizations were very focused on optimizing within the four walls of the DC.

Today, the view is dramatically different. Similar to the chemical building blocks of DNA, retail supply chains today can be described using three distinct sets of building blocks: relationships, tools, and strategic levers. It's no wonder retailers are struggling to find the right combination of these and many other building blocks available for defining the best long-term strategy for survival.

KEY SUPPLY CHAIN BUILDING BLOCKS

Relationships

Manufacturers—mixing centers, vendor managed inventory/customer managed inventory (VMI/CMI) programs, collaboration

Retailers—channel competition, out-of-stock management, differentiation strategies

Service providers—visibility focus, Internet enablement, synchronization

Customers—more choices, less time, less tolerance, more clout

Tools

Processes—flow-through logistics, cross docking, CPFR, perpetual inventory, velocity-based distribution, scan-based trading

Systems—Web-enabled pipeline visibility, global data synchronization, computer-assisted ordering, forecasting, advanced point-of-sale (POS).

Equipment—bar coding, voice-based operations, satellite tracking, RFID

People—internal collaboration, external collaboration, productivity management

Strategic Levers

Price/cost—cost to serve, activity based costing (ABC)

Assortment—micro merchandising, category profitability management

Format—traditional, c-store, dollar, store-in-store

Service—prepared foods, pharmacy, photo, health care and wellness

Compared to the past 10 years of evolution, the next 10 will seem like a revolution. The retail industry is on the verge of a major shift. Competitive pressures, breakthroughs in business processes, new technologies, and stronger management teams will all serve to dramatically change the logistics landscape. Retailers and suppliers will continue to integrate their business models to improve processes and execution. Better POS and inventory input will drive production planning for suppliers. Improvements in demand planning will continue to level flows, and create a model of continuous flow, that will move us away from the historical batch process models.

Against this backdrop of change and challenge, we asked our target companies to share their thoughts about the issues at the top of their agenda. We captured and summarized these as:

- Issues key to strategic plans
- Supply chain trends
- Key elements of successful organizations
- Takeaways for the readers of this report to consider

Key Strategic Issues

1. Maintain High In-Stock Levels

As logistics and supply chain thinking has expanded beyond the DC to the store, retailers are asking how they can do a better job of keeping product on the shelf. That includes having the right amount of inventory on an on-going basis.

Most leading companies measure in-stock items and maintain high service levels. Better performers are in the 95% and above range. Most are short of that by their own measures. But common measurements today do not tell the whole story. To have an item somewhere in the store isn't good enough if the consumer can't find it. It's hard to sell product from a back stock location. Very often, out-of-stock at the shelf occurs, while there may still be inventory in the store.

True leaders are beginning to think at an even greater level of granularity to more dynamically capture in-stock measurements during the most critical servicing periods: when the consumer is ready to select a product. As one retail president said, "Our systems may measure that products are 99% in stock, but the reality is that some products are not in stock at 5:00 p.m. on a Saturday afternoon when it counts." RFID promises to remedy that by acting as a constant monitoring tool to anticipate potential out-of-stock conditions.

IN-STOCK MEASUREMENT DOOR TO SHELF

Typical of several retailers, the president of a major general merchandise retailer is placing increased emphasis on the processes from the store back door to the store shelf. His company has made major strides in creating modern, sophisticated DCs. However, he sees the largest opportunity in this door-to-shelf area. This includes looking beyond the labor component of moving inventory to the shelf, and examining several other components: When it is moved, how it is moved, who moves it, in what quantities, avoiding multiple movements of the same inventory, and placing inventory in the most productive positions. But chief among his concerns is the need to realize a stronger in stock position. He noted:

"Our systems may measure that we are 99% in stock, but the reality is we are not at 5:00 p.m. on a Saturday afternoon when it counts."

Having better in-stock measurements provides the reliable data needed to avoid missed sales due to out-of-stocks, and to reduce shrink.

Some companies try to measure lost sales based on in-stock status. But if you're out-of-stock on your busiest day and during your busiest hours, the real impact will be understated by most current measurements. Retail leaders must consider more "timing sensitive" ways to measure in-stock items.

In-Store Analytics

As the focus on in-stock sharpens, more retailers are beginning to take a look at the "door-to-shelf" opportunities in their stores as a key component of in-stock management. A number of forward-thinking retailers are placing increased attention and serious analytical rigor on evaluating these opportunities.

This includes:

- Space Planning
- Workload planning
- Receipt and stock scheduling
- Perpetual inventory
- Demand forecasting
- Flow visibility
- Data integrity and synchronization
- POS connectivity

Most retailers still lack the tools to properly measure and monitor these opportunities, but successful retailers will develop these capabilities to drive business improvement.

2. Improve Inventory and Supply Chain Performance

Inventory performance is on the minds of an overwhelming number of retailers. Better assortment plans, flow management, improved placement, faster cycles, lower markdowns, higher margins, and better profits are all aspects of inventory performance. Larger companies have made greater progress in these areas. Also shifting is the focus on results. As one senior executive noted, “We need to begin to think in terms of landed profit, not landed cost.”

MOVING TO LANDED PROFIT

"We need to begin to think in terms of landed profit, not landed cost."

These words from a senior retail executive are typical of how the mood is shifting in retail supply chain management. The motivation behind this comment demonstrates a more ambitious focus for this organization on making changes, not because it saves money, but because it meets the broader needs of the business such as improving product freshness or service, driving more customer traffic, or capturing greater, long-term market share, all of which lead to better profit. Flow planning is truly becoming a multi-dimensional issue.

In an effort to focus on improving turnover and providing improved levels of service, retailers apply a range of techniques to manage merchandise replenishment, including rapid replenishment service from regional centers, cross docking of vendor-supported flow, or even restocking from hub stores.

Hub Store to Reduce Overall Inventory

Finding the replenishment model that best meets your business needs varies greatly from retailer to retailer. One creative solution used by a small footprint specialty store in a low-turn environment is the “hub store” concept. By creating a hub store in a cluster region and carrying a slightly higher inventory level, the retailer is able to support the rush replenishment needs of other stores in the cluster. This allows a lower level of on-shelf inventory to be planned overall and saves on replenishment costs from regional centers, which can run on a more predictable schedule.

Inventory management tools will become more sophisticated with specific tools to measure item profitability, SKU and category performance, vendor cost to service and profitability. This is another area where most retailers lack the proper tools and is an issue that should be on everyone’s radar screen.

3. Realize True Supply Chain Visibility — the Next Information Horizon

More advance information will reduce cycle times by enabling problem solving and providing opportunities for more dynamic flows.

There is a strong desire among many retailers to improve visibility of inbound flows. One of the most recognizable areas of new focus is supply chain visibility. This focus takes many forms, from simply knowing the product has shipped, to being able to monitor all aspects of the shipment at every point along the way and generate automated event management actions. For most retailers, this ability is still in its infancy and reflects a desire to have something they do not have today. But it is evolving quickly.

More advance information will reduce cycle times by enabling problem solving and providing opportunities for more dynamic flows. The result will be better flow management with more precise quantities that match true customer demand, and faster replenishment cycles through tighter information management. This will drive improved inventory performance and profitability.

In the future, better information management will lead retailers to accept higher costs for transportation, beyond the current infrastructure-driven increases and different flow patterns, to facilitate better overall inventory, margin, and business performance.

New visibility tools are still emerging, and companies can choose the depth and breadth that is most applicable to the specific products in their merchandise mix. Solutions range from simple notification to automated decision making and event management. No doubt, new tools are going to continue to be developed that serve this critical need.

4. Anticipate Network Capacity — the Key Tactical Issue

The logistics tactician's top issue is how to ensure sufficient capacity and manage growth. The complexities of new sourcing models and dynamic flow management make this even more difficult. A common refrain is, "When will I need to have more assets in place?" The problem is particularly acute for retailers who have thousands of stores where the complexities of servicing so many locations seem endless.

More than ever, the decision to add capacity to a distribution network must be made holistically. Retailers have to ask themselves how current shifts in supply chain thinking will allow more flow management to be handled by vendors or third parties. With the increased demands of speed sourcing and replenishment, product should be handled less frequently and by fewer parties. This may mean the retail DC plays a smaller role in the future.

ALIGNING BUYING WITH OPERATIONAL CAPACITY

We are approaching a critical juncture at which buying decisions and network capacity planning must be reconciled to move retailing to a new level of performance. As one senior retail logistics officer observed,

"Buyers are making decisions without regard to capacity. This will change as buying becomes a more integrated process. Merchants have not been given the tools before."

This retailer, who owns thousands of stores, is expressing a common concern. As he noted, the lack of organized planning and communication between buying and logistics is one of the vestiges of an old retail model that creates havoc for the distribution function. With thousands of stores to deal with, his company is finally addressing the issue by integrating decision making processes, and providing the tools necessary to make buying and allocation decisions that align buying with operational capacity. With those issues reconciled, it will be in a strong position to make intelligent decisions about transportation, storage, timing, and flow release options. Today, those are all managed as exception processes where it is very expensive to correct mistakes that have already happened.

All retailers are faced with this issue. Larger retailers with or without large networks are already taking steps to bring some clarity to capacity planning. **It will be a crucial step for all retailers to begin to move to the next level of performance.**

Supply Chain Trends

In the future, individual companies will manage not one, but several supply chains reflecting multiple channels of distribution, at the same time. This includes direct-to-store, overseas and domestic consolidation/ deconsolidation, true cross dock, flow through and hold and flow, with other variations based on product handling characteristics.

THREAT TO SUPPLIER SOURCES

"To really grow, you have to be innovative," remarked the vice president of operations for a leading supplier to the mass retail sector. He highlighted two issues: The need to be quicker in the market than competitors and the reality that the retailers are simultaneously getting closer to the manufacturing sources as the suppliers get closer to their retail partners. This creates the possibility of a direct sourcing play by retailers.

Retailers and suppliers are increasingly sharing ideas about how to make their joint business more productive. He points out how this is leading retailers to learn more and more about the suppliers' businesses and sources of supply. It is an unintended consequence that this integration of a business model may introduce a retailer to the originating sources of supply, leading them to bypass their traditional supplier partner who does not own the manufacturing capacity.

This company recognized the implication for suppliers to be better producers of ideas and concepts that transcend the commodity supply market. That is exactly how they have successfully positioned their business.

1. Retailers are Moving to More Direct Sourcing

Direct sourcing by retailers will continue to expand at a rapid rate. With more sophisticated global sources and retail organizations, the move to secure increased margins through verticalization of the business has accelerated. This move is more noticeable with larger retailers who can leverage scale, but is also beginning to show up in smaller retail companies as the cost advantages have become too large to ignore.

This creates multiple challenges for the supplier community. The obvious immediate consideration is, as product becomes commoditized, it is easier for a retailer to go to direct manufacturing sources and bypass traditional suppliers. Fortunately for the supplier community, it is a little more involved. While some retailers excel at direct sourcing, many still have much to learn about these programs.

Successful retailers must innovate to differentiate their offerings in the marketplace. Retailers and suppliers who can leverage such innovation will lead their markets.

Future products will escalate to commodity status more rapidly due to global sourcing options, and improved speed and access to information. These "commodities" will be partially verticalized by larger retailers aggressively looking to streamline processes and tools for direct sourcing. They will maintain brand name suppliers to attract traffic and absorb the volume volatility risk, but they will carve out significant portions of core businesses that they manage themselves. This will be a competitive advantage for retailers. It also means different types of inventory flow will be managed through the supply network.

Retailers need to build credible direct sourcing functions, which will become the templates for future programs. Direct sourcing means retailers will have to be more sophisticated in planning and managing product flows from the point of production, including creating different strategies for staging, packaging, load building, rate of flow, consolidation, and distribution to the stores.

Noteworthy suppliers will add value to product innovation or service (i.e. speed or processing) to capture business and grow their market.

2. Assortment and Demand Management are Becoming More Sophisticated

Merchandising management is rapidly becoming more sophisticated across retail. Tools for planning and managing assortments, price, and exiting continue to improve daily. More retailers are beginning to aggressively think about editing assortments in a more rigorous manner to replace low-performing SKUs with new offerings that balance the line. Also more integrated demand planning with suppliers is driving inventory reductions and performance improvements.

REFOCUSING YOUR ORGANIZATION ON OUTCOMES

"We used to be a buying organization; now we are a selling organization."

— Director of supply chain for a major regional grocer

This regional grocer has slashed inventory by hundreds of millions of dollars through several initiatives, including forecasting and demand sharing with vendors. With much opportunity still ahead, it is transitioning to managing the business with tools and processes focused on the outcomes of product procurement and not procurement itself.

It is also more tightly managing and integrating vendors, leveraging them, and in one example, working with vendors to create cross-dockable, promotional displays that incorporate merchandise from several vendors.

3. Tailored Assortments Will Become More Common for Smaller Store Clusters and in Some Cases, for Single Stores

There is an increased focus on tailoring assortments to specific stores based on demand for retail differentiation in the marketplace. This is often discussed as micro merchandising to the individual store. The reality is more likely to be assortment plans merchandised to smaller clusters of stores with a common set of attributes.

This will drive profound changes in the supply chain and logistics operations, including an increase in initial store-specific flows, customized replenishment by store, greater store pick-and-pack activity from vendors, and smaller unit packs. This will mean significant changes to transportation flows and DC networks and processes.

Customized Assortment

A key factor in assortment planning is developing uniqueness that differentiates one retail offering from another. Suppliers have a major role in bringing new solutions that offer unique propositions to their retail partners. A good example can be found in the recent history of Toys “R” Us which has been battered by fierce competition in the toy sector. In 2004, the vendor community decided a good way to bolster that business, and its own future, was to create some unique assortments for Toys “R” Us. This is a strategy that should have been deployed a decade ago.

4. Cross Docking is Gaining Momentum

Many companies are not structured, from a physical or process perspective, to reduce product handling through more level demand flow and cross docking applications. But there is clearly an increased focus on moving to such a model in the future. For many retail organizations, this model could push cross docking flows above 50% of volume. This strategy dramatically lowers handling costs and, when executed as part of a balanced inventory management program, can help reduce inventories and improve performance.

While providing many strong benefits, cross docking will also require significant redefinition of business processes and reconfiguration of DCs to accommodate such flows. This means changes to receiving and shipping processes, conveyor and material handling systems, and warehouse management systems (WMS).

5. Transportation is a Major Concern for All

Transportation concerns are near the top of everyone's list. The issues are universal and straight-forward:

- Rising fuel costs
- Driver shortages
- Port congestion delaying shipments

As service users, most retailers feel powerless to change these issues, and are left to determine the best way to deal with the consequences that evolve. Very large companies with scale and greater influence have been able to mitigate some of the delay impacts through advanced planning and preparation, and by working with carriers and port agents. A number of retailers are trying to route product through different ports to avoid the delays.

In addition to truck capacity issues, rail also has bottlenecks and capacity constraints that aggravate the problem for retailers.

6. Maturing DC Design Characteristics Have Leveled the Playing Field and Been a Major Investment Area for Retailers

One of the major investment areas that we have seen in the past decade has been in modern DCs. DC designs have evolved and matured as better design characteristics are shared across the industry. Today's facilities share many common features across the retail spectrum, including:

- Conveyorized receiving to offload and direct flows.
- Multi-level pick to conveyor modules.
- Pick to light, voice, and put to store modules.
- Wave processing.
- High-speed case sortation.
- High-speed unit sortation in a range of tray and cross belt forms.
- Online terminals mounted on lift trucks and carried by people.
- Integrated WMS solutions that impact receipt scheduling, off loading, replenishment pulling, picking, packing, trailer loading and scheduling.

There are still some segment differences among retail and direct-to-consumer businesses. However, those differences have developed due to functional activity (i.e. piece picking, returns processing, etc.), than business differences as each of these segments has adopted design practices from the others.

There are also still some differences between the high revenue volume segment (i.e. $1 billion and more) versus its smaller competitors who cannot afford the same level of investment in equipment and technology. The smaller players are, and will remain, at a competitive cost disadvantage.

The larger mass, drug, and dollar channel players have established a core, or "cookie cutter" design, upon which future designs are based. These designs have become very efficient engines for processing large quantities of product.

7. Typical Operating Costs Broken Down

The most commonly asked question by those who study these survey results is, "What should my cost be as a percent of sales?"

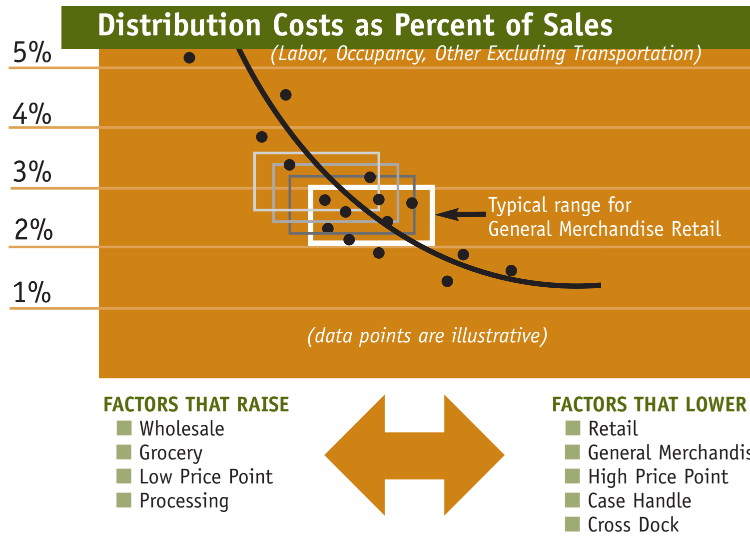
Operating cost targets are a reflection of a business' characteristic and how well it can operate within the parameters that define them. Yes, it may have similarities to some other companies, but in many ways it is quite different.

Constant dollar costs have continued to drop as distribution operations and logistics networks have matured. A few of the leaders are beginning to take an in-depth look at the true cost to serve based on package size, handling mode, flow methodology, inventory turnover, and margin realization, which will drive new strategies for merchandise flow management.

There is no single answer for how much cost should be applied to all businesses. It depends on many factors: Are you wholesale or retail? Is your product grocery or general merchandise? Do you have a low or high price point? Do you do much processing in the DC or are you cross docking cases and pallets?

But patterns do emerge, as illustrated in the chart below. Many general merchandise companies tend to cluster around a range of 2-3% for all distribution costs, excluding transportation.

This number has been drifting down slightly for several years as many retailers have continued to take costs out of their businesses.



SETTING GOALS

You have to look inside your own company to figure out what your potential is and how to best tap into that.

"We measure ourselves against what we can be, not so much against what others have done."

These words from the president of a large general merchandise retailer offer some great advice. This retail president recognized long ago that comparing himself to others may provide a context, but if your goal is to achieve the benchmark level of performance of others in your industry, you will always be behind. By the time you reach the benchmark, those companies will have moved on to performance levels that are often dramatically different.

8. Partnership Teams are Becoming a Strategic Weapon

There is an increasing reliance on supplier partners to act as true planning partners. Early involvement is giving retailers better benchmark information with which to plan their programs. This is also changing the mindset for suppliers from selling product to the retailer to one of selling product to the consumer.

Virtually all leading retail organizations today assemble teams of cross-functional resources to meet with a corresponding supplier team to discuss current business processes or plan new programs. These teams address packaging and handling, information, and logistics flow issues. Increasingly, these discussions are moving further upstream into the manufacturing process and tying back to information that originates at the point of sale. The make-up of the teams from one organization to another varies, but the concept is consistent.

STRONGER SUPPLIER LINKAGES

"More than ever, we are gaining input and asking for involvement from our suppliers in the very early planning stages".

This observation from a senior supply chain executive at a major general merchandise retailer is typical of a pattern that is emerging across retail. He went on to note that this integrated approach is also a good source of benchmark information to help the retailer better understand what is developing in the supplier community. He has been sharing some of its own future plans with suppliers who, in turn, are further developing their own plans, networks, and manufacturing sources.

An obvious implication for the supplier community is that it presents the opportunity to be positioned with long-term relationships that offer stability to long-term business prospects.

9. Small Box Productivity

This is an issue specific to the small box retailer, but so significant to business that it is important to highlight here.

Particularly for small box retailers, there is a real concern about how to drive more productivity from the same space. The box isn't getting any bigger, but each year you have to get more from it. This has clear implications for managing assortments more aggressively and to offer items that customers are buying and to produce an acceptable margin. Room has to be created for new SKUs by editing out old SKUs.

It also adds pressure to increase inventory movement as part of improving inventory performance. Faster turnover creates more selling productivity for the same space. The impact of this will be felt upstream as changes in product life cycle, replenishment cycles, and in-store display quantities drive changes in the logistics and supply chain network, including:

- More items moving to replenishment models.
- Different replenishment sourcing and flow models.
- Greater differentiation of margin productivity when making decisions about how much replenishment should go to the store in one movement. High margin and highly volatile SKUs will be worth higher inventory risk to ensure every sell opportunity is capitalized upon.

10. Future Flexibility ... Planning for Obsolescence?

Executives should begin to ask themselves, "When will my DCs become obsolete?"

We are entering a period where there is going to be rapid compression of supply chains. The challenge for retailers that have developed complex logistics networks, and who are developing them today, is to keep their designs and plans flexible. Change will inevitably require these facilities be rethought. These changes indicate that:

- Product development and sourcing lead times will continue to shrink as a result of the need for faster consumer response.
- Tighter integration among suppliers and retailers will lead to better product creativity, faster response to strong sellers and/or clear weak sellers, more extensive testing, and faster speed to market.
- Inventory turnover will accelerate, requiring new flow strategies through distribution networks.

It is inevitable, as inventory flow becomes more sharply aligned with demand, that we will see smaller packaging and increases in unit handling. This will not only mean increases in pick-and-pack activity (much of which will be pushed upstream to vendors), but changes in packaging size to permit more unit inner packs. New facilities should anticipate changes in future product flows and build in flexibility for more cross-dock flow.

Difficult questions that logistics and supply chain executives should begin to ask themselves are, "When will my DCs be obsolete? When will the dynamic changes move me to handle less product in more of a true unit cross-dock fashion? How will I reconfigure the assets I am putting in place today? What will the demands of rapid replenishment service do to drive me closer to my stores?"

The store is one large remaining untapped opportunity in the supply chain and repairing that will have a profound impact on the logistics and supply chain network.

The store is one large remaining untapped opportunity in the supply chain and repairing that will have a profound impact on the logistics and supply chain network. If retailers can replenish in a few days to a couple of weeks from domestic vendor distribution points, and in six to nine weeks from the Far East, which could be flowed in waves, why are retailers still carrying 15 to 20 weeks of inventory on the shelf? As this concept takes hold in retail organizations, the support required from retail DCs and their vendors will change measurably in terms of the characteristics of how flow is managed and the facilities required to handle that.

Elements of Successful Organizations

1. Investing in Business has Evolved as a Strategy

A more comprehensive view of how results can be improved at the store and with the consumer has emerged. Top companies are moving away from models that optimize functional areas (i.e. logistics), and are making more holistic decisions with cross functional boundaries that drive company profitability and growth.

It has become commonly acceptable (though still short of universal) to spend a dollar in logistics if you can save two dollars somewhere else in the business.

NEW MODELS EMERGING

"What I want to know... is there a better way to do business?"

— Senior retail supply chain executive

It was striking during these interviews to observe the consistency with which today's leading retailers and suppliers have been significant investors in their businesses over the long term. This includes investments in assets, processes, technology, and people, which is evident when you walk through the new DCs companies have built, look at technology that has been deployed, and meet the management teams that have been put in place. Even more striking are the relative choices companies have made with those investments and the structured process of prioritizing and selecting areas in which to invest.

These have generally not been investments based on least cost. Sometimes least cost does show up as best value. But lowest cost has not been the focus of decision making. Rather, among the broad group that has maintained some level of growth, these have been sound investments based on best value and greatest impact. They have not been based on simple justifications, but on the expected broader business outcome, and have included investments in:

- High-end equipment that provides more durability and greater throughput capacity.
- Software technology that provides new capabilities for connecting with suppliers and improving inventory movement.
- New business processes that redefine merchandise planning and assortments and create better sell-through.
- New channels for flowing product faster to respond to market opportunities.
- Strong and deep management talent that is continually improving.

1. Investing in Business has Evolved as a Strategy *continued*

By contrast, companies who have struggled with performance have had a more fractured decision-making process for investing. There is also less focus on a long-term view or plan, and decisions are not made in a consistent manner to provide the best return on investment.

There are still countless areas for even the most successful companies to focus and improve. But this pattern says something about their willingness to make complex choices wisely. There was a time when retailing lacked the sophistication to make solid business process decisions. The hallmarks of successful retailing have moved beyond selecting good product to include a range of issues around price, format, and service, and these leaders have transformed their management decision processes.

Though it seems like such a simple notion, it is actually quite important. Today, any retailer that is not investing in its business will soon be gone. Competition driven by improved business processes will be brutal. A regular process of reviewing investment priorities and acting on those that are most important is essential to moving the business forward. Looking back at the past decade, countless retailers chose not to invest, opted to continue the status quo, and eventually succumbed to their strong competitors.

This ability to make more sophisticated decisions is also one of the key reasons that the pace of change will move even faster. The ability for retailers to recognize and react is so much better today.

A regular process of reviewing investment priorities and acting on those that are most important is essential to moving the business forward.

2. Culture — The Glue In Many Successful Organizations

Perhaps it should be self evident, but we were profoundly struck by the frequency and strength of conviction with which senior executives cite culture as a critical component driving their success.

Successful retail organizations do have a strong and defined culture. But is the culture a result of the success or is the success the result of the culture? We think it is the latter. A strong culture is what helps carry businesses through the challenging periods all businesses must inevitably face.

Culture in the companies we reviewed began with a set of beliefs about what they wanted to stand for. Those beliefs were then repeated often and shamelessly to reinforce their messages. They are posted on walls and are repeated at company meetings. As success is realized, it reinforces the beliefs, further engaging and energizing people to achieve higher productivity.

MODELING CULTURE

Joe Scarlet, Chairman of Tractor Supply, often speaks of the frequency with which his company reinforces the cultural messages that define what it is. At virtually every major gathering of company personnel, the messages are repeated and reinforced so everyone always knows what Tractor Supply stands for and the type of company it aspires to be.

If success is not realized, and there are examples of that, elements of the culture and business purpose must be redefined.

Outwardly, culture may take many forms, from the unabashedly proud Wal-Mart cheer with a squiggly just for fun, to a simple code of conduct posted on the wall, to an environment of common understanding. It represents the values and principles senior management espouses. In successful companies, these values and principles are common:

- Have passion for the business and the customer.
- Deliver great value.
- Treat people fairly.
- Communicate openly.
- Work and play as a team.
- Give honest feedback.
- Recognize, appreciate, and reward.
- Be consistent.

Culture is …

"Culture is the way we do things, how we react, what we believe in, consistency of talk and action. It's working together."

The above statement was from a senior retail supply chain officer for a broad line general merchandiser. But it could have come from any of the interviewed executives.

For this company, its strong culture is what attracts and retains good talent. It's the critical element that translates a challenging time ahead into a new opportunity for growth and expansion. And, the way management reacts during those difficult times is what validates the culture in the minds of all associates.

When you talk to people about how they create and maintain culture, they are hard-pressed to capture the process in words, other than to say they exemplify it every day. Living by example is the best way to demonstrate and model desired behavior.

2. Culture — The Glue In Many Successful Organizations *continued*

Regular meetings to reinforce focus are critical. Many companies meet to review results from the week, and make plans for the next week. Wal-Mart is famous for its Saturday meetings. Other organizations meet on a Monday schedule.

A strong culture does not mean a lax attitude and low expectations. Actually, quite the opposite is true. It is more common in a strong culture to have clearer performance expectations and more honest feedback and dialogue.

Offsite activities that include multiple levels of the organization create a common focus for some organizations. For some businesses, the unique nature of the business itself creates a common ground for people to focus their energies.

The level of team spirit does vary greatly from company to company. Some push it daily; others are more modest in their approach. Both can succeed. The element of regular communication of a company's position is important to all.

Many strong cultures have developed through the internal growth and development of people "through the ranks." This has served to continue an esprit de corps and camaraderie around a cultural theme. Growing your own culture without external additions will not bring the success that is required to compete today. It is possible to bring new additions into an organization in a way that not only supports, but enhances its culture. This is true of most leading retailers today who have a history of promoting from within and have selectively added key resources from outside the business.

To be sustained, the culture must be resident and long term in an organization, part of which means creating an environment that receives others. A key to doing this is selecting others who share common value systems that are reflective of your culture. The result can be an organization in which culture is enhanced, rather than a collection of diverse opinions where decisions are difficult to reach.

To be sustained, the culture must be resident and long term in an organization, part of which means creating an environment that receives others.

Takeaways to Consider

Armed now with some knowledge of what the industry's leaders are thinking, how should you use this information to improve your own business?

At right are some suggestions.

1. Reaffirm Your Cultural Message

Take a fresh look at your core beliefs and culture and how you are communicating those messages throughout the organization every day. Revisit the processes with which you speak to these values as part of every meeting. Speak the messages. Post the messages. Live the messages. Cascade the messages from the top of the organization throughout your company.

2. Make Strategic Planning a Continuous Process

Institute a process that regularly reviews the future of your business and how you will get from here to there. What changes will be required in processes, organization, and technology? Maintain a priority list of actions to take and timing for those actions and update it regularly.

3. Rate Yourself on the Issues Highlighted in this Report and Prioritize Actions

Consider each of the issues noted in this report and ask yourself where you stand today and what your plans are for addressing them. This includes in-stock levels, inventory performance, supply chain visibility, tailored assortments, network capacity plans, direct sourcing, and much more. These are key issues that must be addressed because your competitors already are doing so. The choice is when and what other priorities might supercede immediate action.

4. Future Think

Begin to consider what your business might look like in the future as these changes are realized (e.g. doubling of inventory turns, product cycle times that are cut in half, smaller inventory levels in stores that drive more precise information control and replenishment, packaged flows from vendors that are cross docked through your facilities). What will your network look like when that day arrives? Think about this now so that the future decisions you make about facilities, processes, and technology over the next few years move you towards this vision.

A new era of supply chain execution is at your doorstep. It will come swiftly and be characterized by new vertical business models that integrate suppliers and retailers in a more rapid and reactive response to true consumer demand. It will lead to further rapid evolution of Retail DNA. It is not too early to begin to plan your role in that era.

Retail DNA

Unlocking the Secrets of Supply Chain Excellence

Appendix

During the presentation of this study

at the 2005 RILA Logistics Conference,

some additional information was gathered

from the attendees in the audience.

This is summarized in the following pages.

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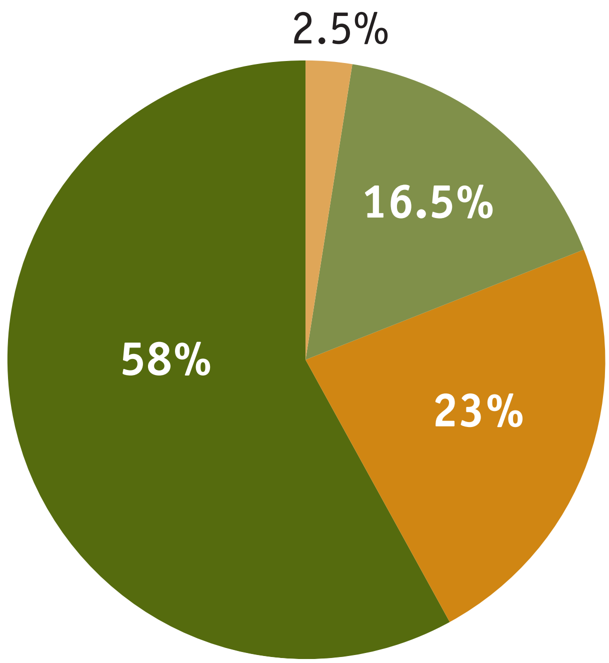
RETAIL INDUSTRY LEADERS ASSOCIATION

Appendix

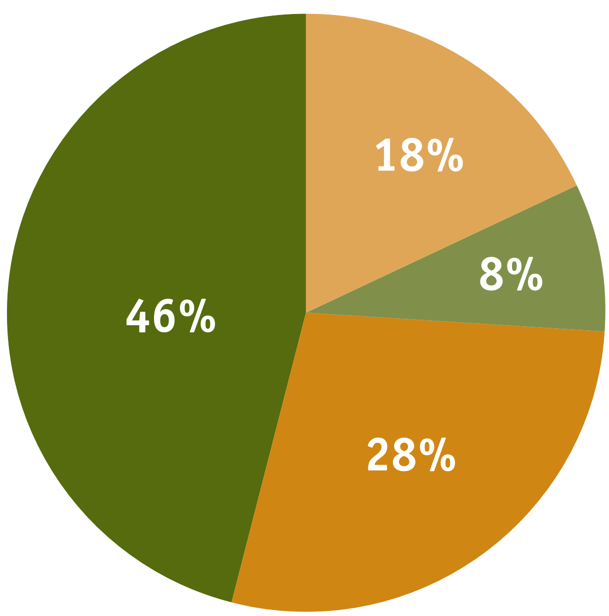
Company Size for Respondents

% of RETAILERS

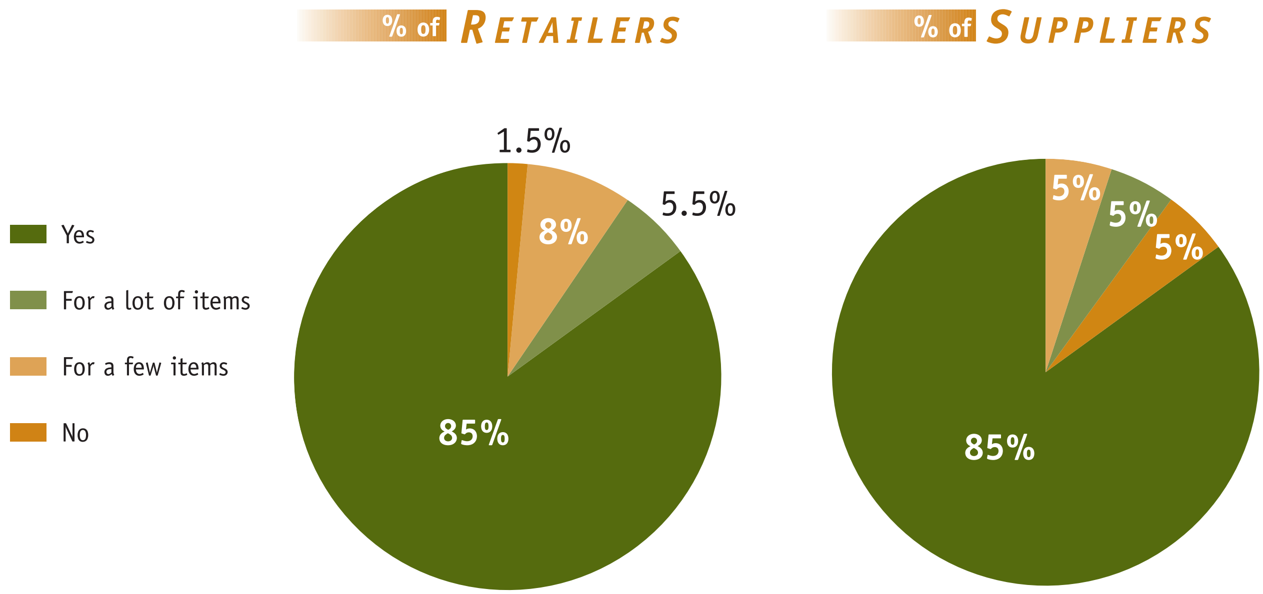


- < $500 million
- $500 million to $1 billion
- $1 billion to $5 billion
- > $5 billion

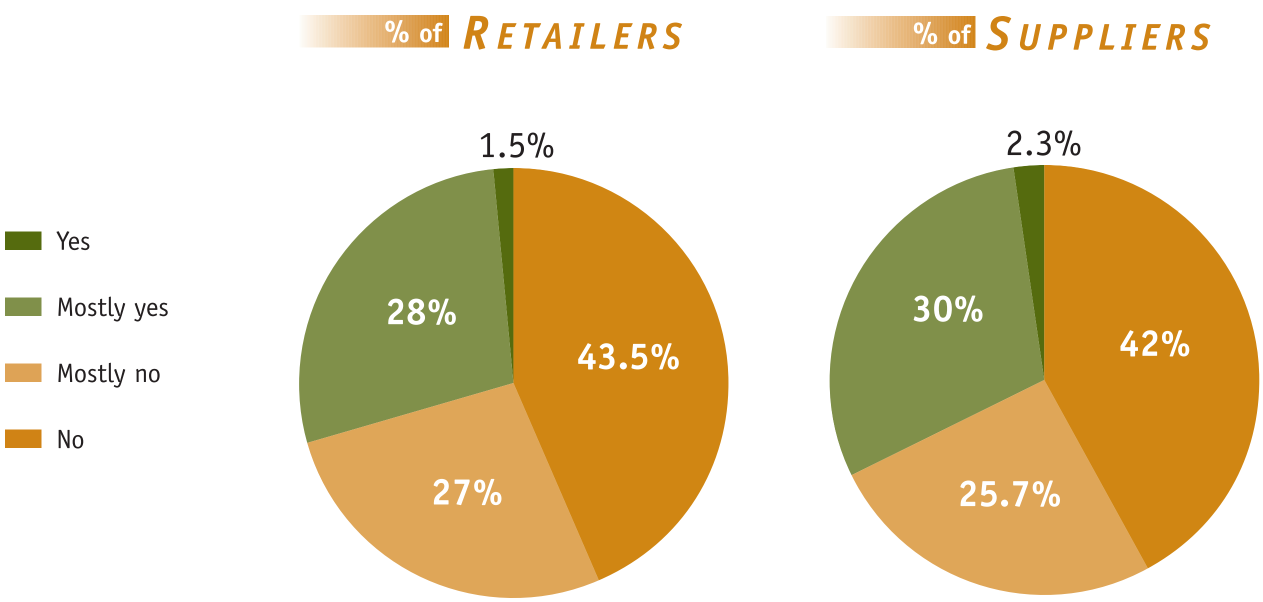
% of SUPPLIERS



Do you monitor in stock levels?

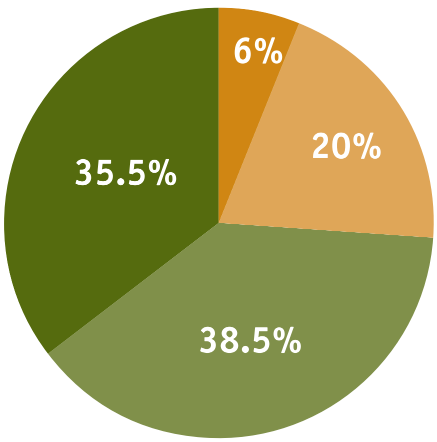


Are you satisfied with your in stock levels?

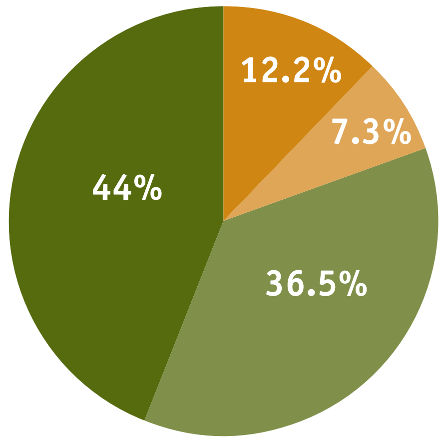


Do you have some sort of visibility tools today?

% of **RETAILERS**



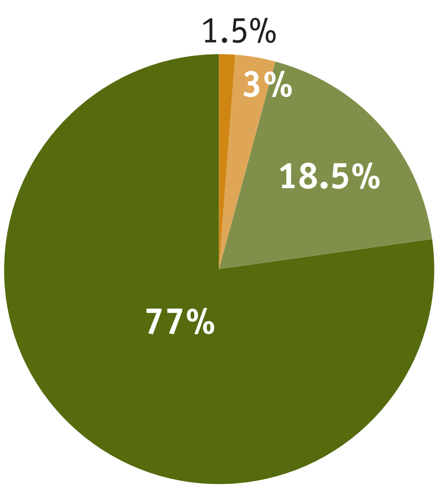
% of **SUPPLIERS**



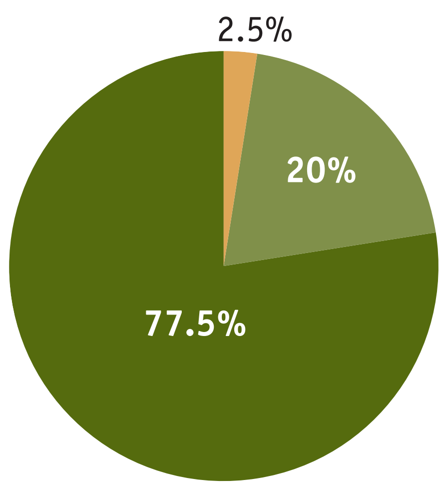
- Yes
- Mostly yes
- Mostly no
- No

Do you expect to add greater supply chain visibility tools in the future?

% of **RETAILERS**



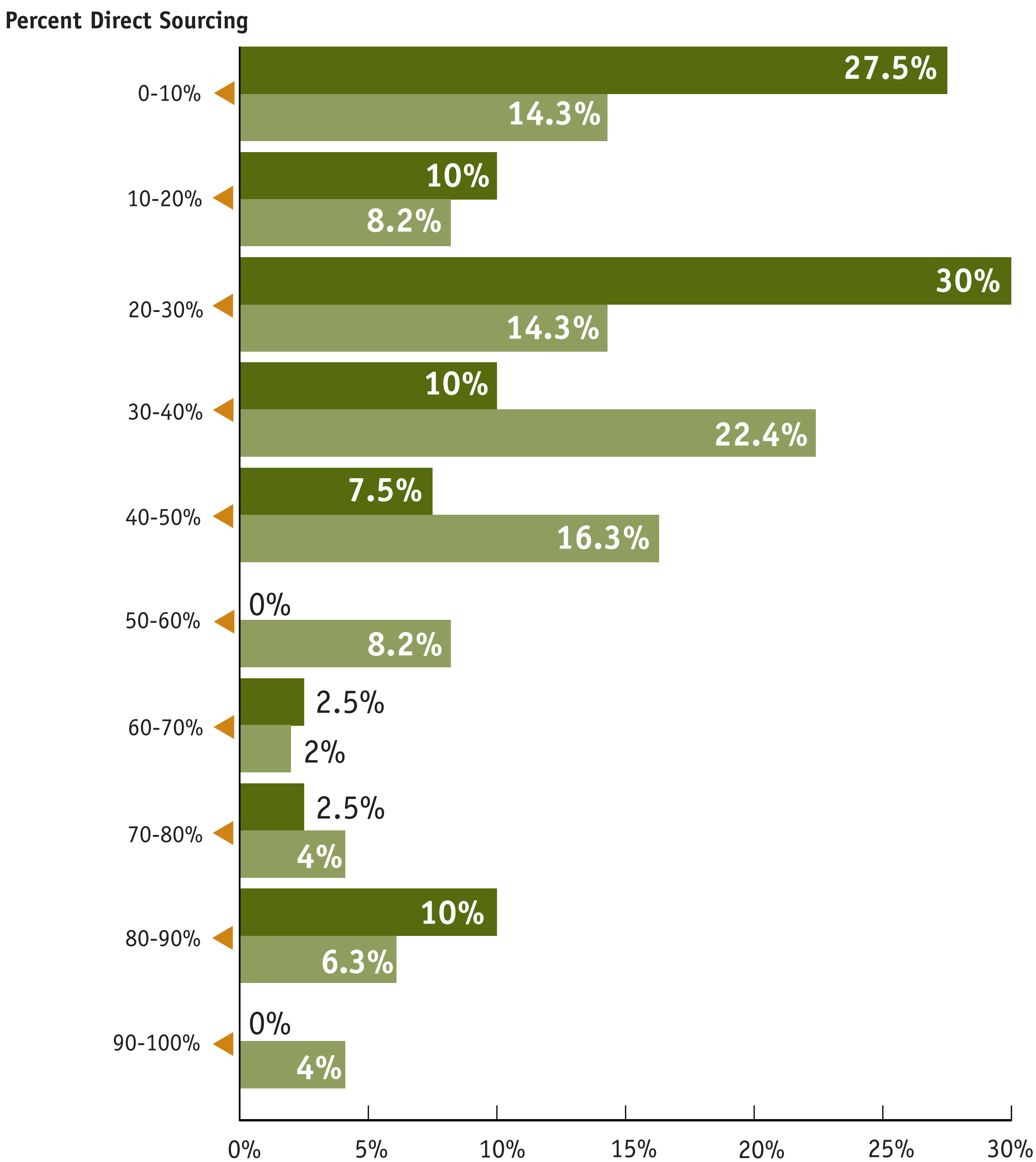
% of **SUPPLIERS**



% of RETAILERS

How much direct sourcing are you doing today?

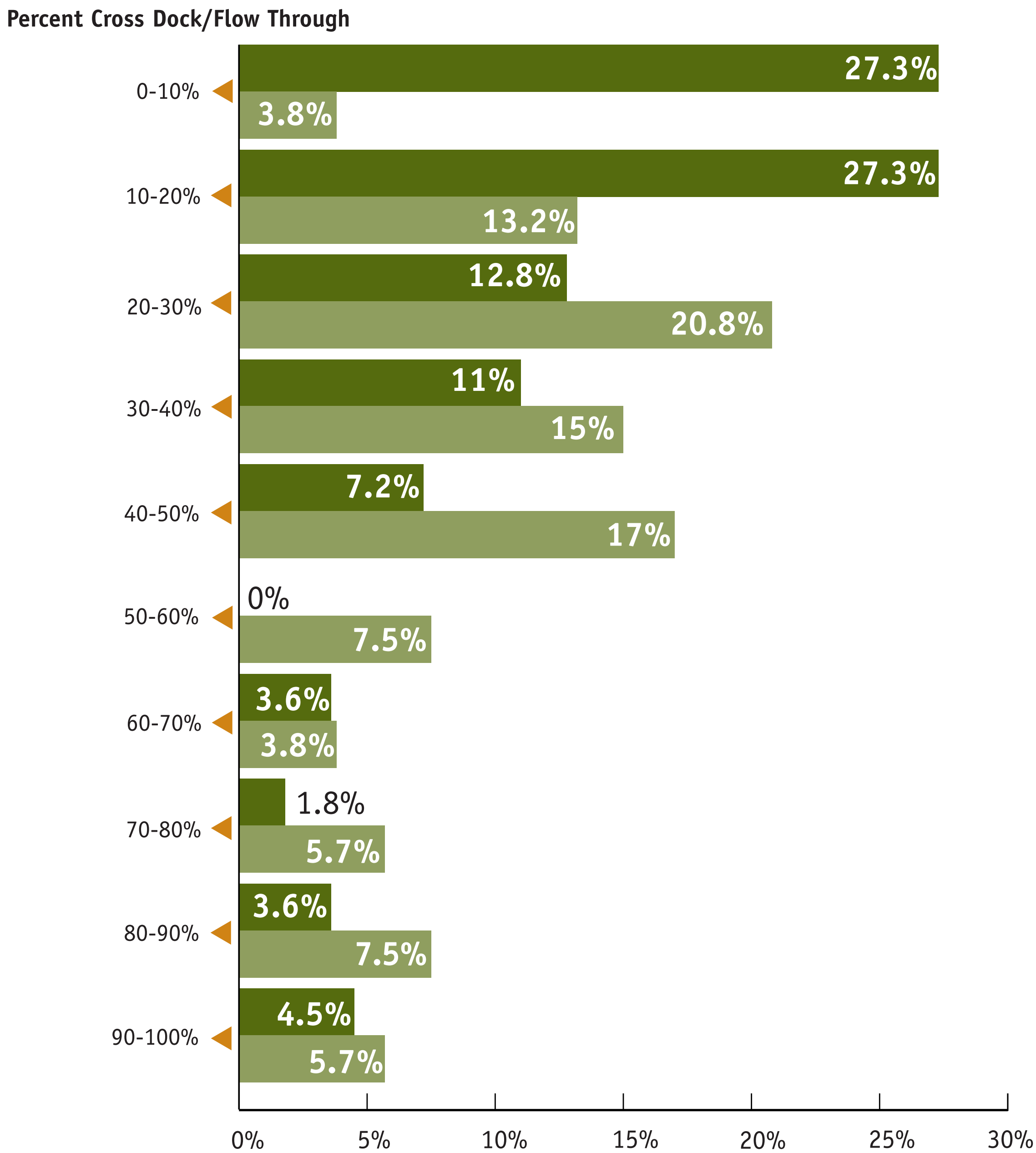
How much direct sourcing do you expect to be doing in five years?



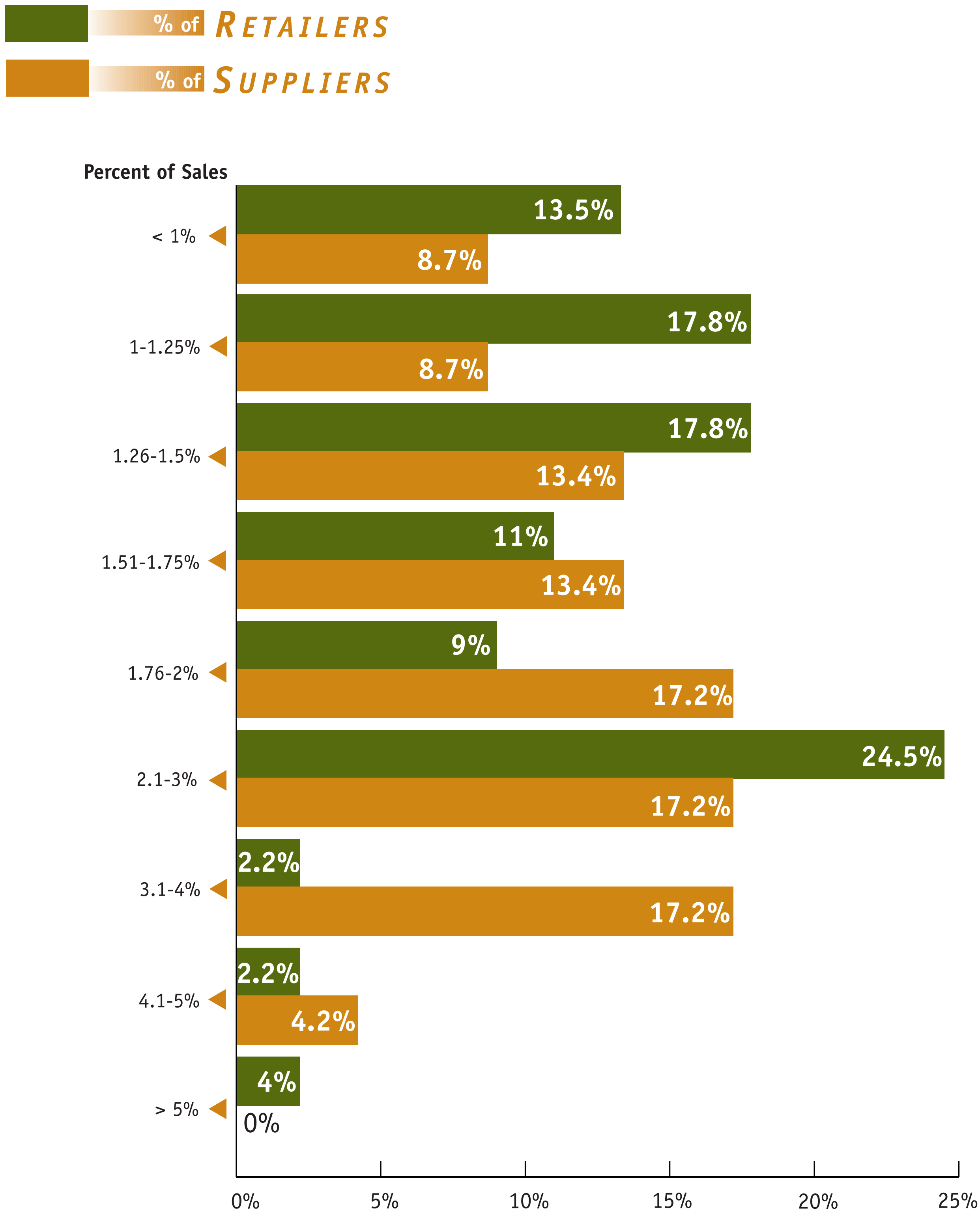
% of RETAILERS

What percent of units do you cross dock/flow through today?

What percent of units do you estimate you will cross dock/flow through in five years?

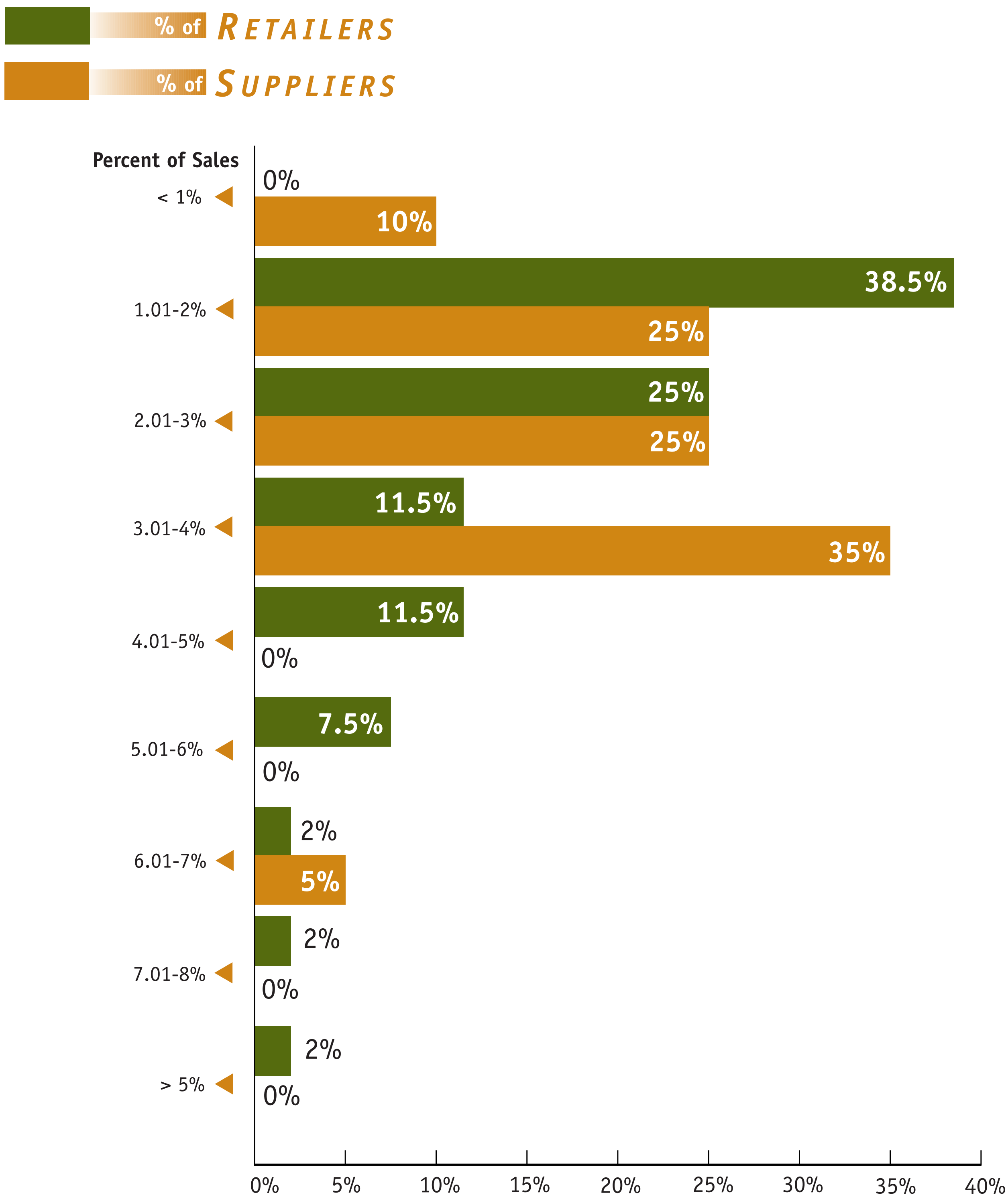


What is your outbound transportation cost as a percent of sales?



Appendix

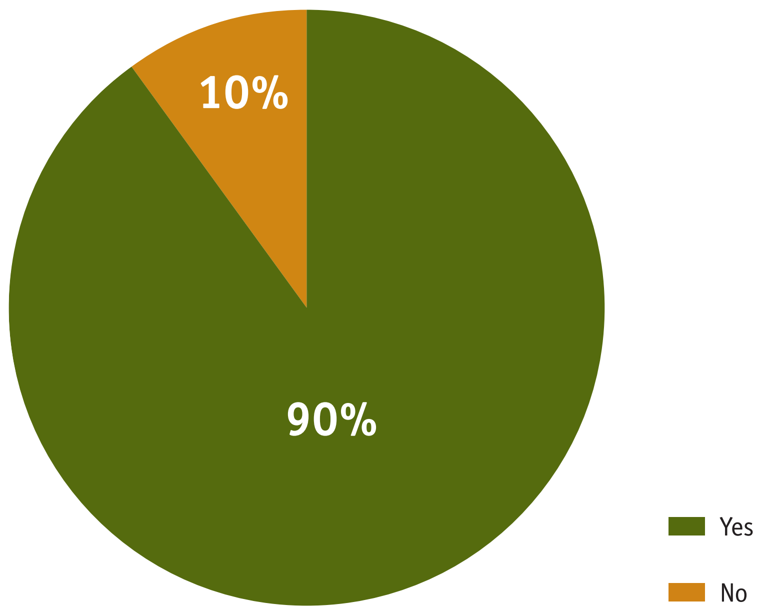
What is your total distribution cost, excluding transportation, as a percent of sales?



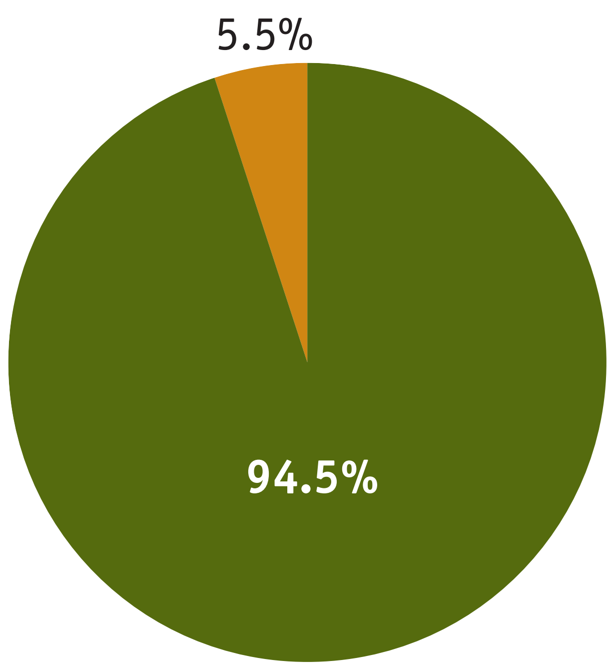
KSA www.kurtsalmon.com RILA RETAIL INDUSTRY LEADERS ASSOCIATION

Do you assemble teams to work with your supplier or retail partner?

% of RETAILERS



% of SUPPLIERS



Educate, Innovate, Advocate