Who will be the retail champions of the future?

By Joe Booth - Director, StrataBridge

In the old retail model of supply chain management, retailers relentlessly squeezed their suppliers for lower prices. This allowed the retailers to maintain their margins, despite enormous downward pressure on prices from global competition and new technology. Suppliers, reluctantly, went along with this as there was an obvious benefit to them in that through the retailer they had access to a huge consumer base that would otherwise not be available to them.

But the "squeeze them till they squeak" strategy is about to hit the buffers. After years of crying 'wolf', suppliers are facing being driven out of business by the prices their retailer customers are prepared to pay and the deadlines those customers demand.

In the interests of both the suppliers and the retailers, a new model needs to be found.

Conventional wisdom

The retailing business model that seemed to work best in the past was as follows. First come up with a great concept – such as power brands for competitive prices, or "everything for £1", every day low pricing or one-stop shopping. Then select the right location for your outlet: the high street, the shopping mall, the airport, the corner shop, etc. Make it pay. Prove it works. Sweat the assets. Finally, gain economies of scale through expansion by opening up more outlets in the right locations.

In principle, there is nothing wrong with this model. It worked very effectively for Wal-Mart, Ikea, Carrefour and Tesco. These companies emerge in business school case studies as the stars of retailing, celebrated for their visionary leaders, corporate culture and values, use of modern technology, and their power to squeeze and shape supply chains.

The fly in the ointment is the consumer, whose behaviour is changing in unprecedented ways. For shopping that's a chore, people can now choose to avoid the store altogether and have their goods delivered. For "shopping as leisure and pleasure", people want personal service, not queues and hassle.

Essentially, the boot is now on the other foot. The supplier may have called the shots when demand exceeded supply – as was the case in Western Europe up to the 1970s, and in Eastern Europe up to the 1990s. When supply started to outpace demand, retailers became exposed to real competition, the consumer became "king", and retailers turned to the other side of their business – their supply chain – to find their profits.

Year in, year out, the major retailers exercised their power over their suppliers, demanding another 5% reduction in prices, cutting another week off lead times. Year after year, their suppliers complained – but managed, somehow, to pull it off. So retailers were able to bring down prices for their consumers – and announce another year's record profits.

Why can't retailers and suppliers carry on in this virtuous circle?

Drivers of change

Mainly because the circle has speeded up considerably, driven by three major forces: globalisation, the single European currency, and new technologies.

First, globalisation. Thirty years ago it was common for retailers to source from their own national suppliers. Today, supply sources can be anywhere in the world: China, Vietnam, Morocco, Eastern Europe, Mexico, the USA. Retailers today have more purchasing power than they could have imagined back in 1970. UK retailer Marks & Spencer (M&S) was criticised in 1999 for missing a trick, because it was then sourcing all its apparel from the UK – the City felt it could make much more profit, and offer its customers better value, by buying globally. The subsequent change in policy has certainly paid dividends for M&S and its shareholders.

Our second driver of change, the Euro, also makes it much easier for consumers to compare prices. This transparency is creating a downward force for price harmonisation that will be difficult to reverse. Already this is working its way back through the value chain.

Meanwhile, new technologies are doing their own bit to drive down prices. Only a measly 5% of us buy directly from the Web – but many more of us use it to compare prices at home and abroad. The impact is clearest, perhaps, in the way British car prices are dropping. Loyalty cards integrated with EPOS data and powerful CRM software ensures that retailers can scrutinise our buying habits – and further technologies allow them to respond by changing prices quickly and effectively.

Lessons from leaders

Already, there is a lot to be learned from companies that have successfully challenged the old supply chain paradigms. Their experience shows that there is more than one type of retail supply chain.

Take Nike, a power brand and retailer who revolutionised one aspect of the supply chain. Nike products were sourced to high quality standards from third-world countries – and then transported by air to replenish demand in its major markets: Europe and the USA. At the time, air transport was considered a last resort in the retail industry – a desperate means of covering errors in supply chain replenishment. Nike used it to gain real competitive advantage in the extremely fast-moving sports fashion sector.

Another example: Benetton, and later Zara. Both challenged the paradigm that you ***must*** buy from third-world sources to deliver value in the international fashion arena. Each of these retailers built supply chains on the premise that supply would come mainly from its home market – Italy for Benetton, Spain for Zara. Each company expanded its retail outlets internationally. The key to their success: rapid replenishment from supply source to stores.

In the brutal, unforgiving fashion business, having the right stock at the right time can appear to involve more black art than science. What sells well you seldom have enough of in stock; what does not sell well you seem to have in abundance. Add to this two seasons of completely different styles per year and you have a highly pressurised system of supply chain and inventory to manage. Achieving rapid time to market coupled with rapid replenishment systems really means challenging every process, sub-process, activity and procedure. The winners must aggressively invest in responsiveness; delays cannot be tolerated.

What can Luc Vandevelde's new M&S teach us? Under pressure to source more competitively outside the UK, M&S answered the call of the market and sourced some 30% of garments from the third world. But when its new Autograph range was launched, revealing fashion styles from four top designers, M&S decided to source the whole range from one single UK source. Why? Because, in the fashion world, true partnership can be the safest way to achieve the rapid replenishment systems essential for the sector.

The M&S Autograph category team and the Courtaulds Ladieswear team forged a common strategy. This created a single team with common documents, process and information. Waste in the supply chain was squeezed out by the two companies working together. Success became dependent on both sides performing well. The outcome? We still don't know, but it feels right.

The retail supply chain of the future

Clearly, the old paradigms – "squeeze them till they squeak" and "one size fits all" – have had their day.

Smart retailers will recognise that they may need different types of supply chain for the different types of product that they carry. They will design their own natural supply chain types, and optimise them to release maximum value. And they will work with their suppliers rather than against them, seizing opportunities to drive costs out of the supply chain altogether rather than simply passing them on to someone else. This is the only sure-fire route to sustainable success.

Where should they start?

The first question to consider is: "Where does our competitive differentiation come from?" From the answer to this, the business strategy unfolds. The job of the supply chain is not only to support the strategy – in retail, as with other sectors, it is likely to be an integral part of it. Strategic design of a retail supply chain recognises that there can be many types for one retailer, and optimises each one individually.

Five elements forge the different supply chain types and make it possible to distinguish one from another:

Value proposition – The different ways in which you add value for your customers and consumers will shape how you design your supply chain, and how you balance your specifications re time, quality, and so forth. Harvey Nichols' supply chain will be different from Poundland's.

Margin – High and low margin products will justify different supply chains. High margin products can use air transport for rapid response. Low margin products cannot.

Predictability – The accuracy with which you can forecast supply and demand is an important design parameter in the supply chain. Predictable products (e.g. tea bags) can use efficient, low inventory, highly utilised assets. Unpredictable demand (e.g. for a new fashion item) needs spare headroom capacity for impulse demand.

Volume – Different product volumes require different supply chains. High volume SKUs (stock keeping units) can justify automatic capital-intensive equipment to drive down cost. Low volume SKUs, on the other hand, need to be managed very differently to optimise the value for the entire business.

Seasonality – For those bold enough to challenge the old supply chain paradigm, seasonality has its own unique impact. There are two opposing supply chains for the same product, caused by seasonality. Out-of-season products demand an ***efficient*** supply chain, while in-season products require a ***responsive*** one. Thus to optimise a seasonal product in the same factory with the same people, totally different measures and behaviours should be adopted depending on the season. Imagine how confusing that must seem to the workforce.

For each type of supply chain, optimisation can have a significant impact on a number of design variables:

- Sourcing location
- Replenishment rules
- Safety stock levels
- Transport types (air, sea, road)
- Factory utilisation levels
- Distribution networks

And now it starts to become apparent why M&S sourced some apparel from the third world, and its Autograph range from a UK site. For its 'standard' stock with dependable demand forecasts, M&S needed low-cost efficiency to ***push*** the stock through the system as effectively as possible. For the more distinctive, less proven Autograph range, it needed a supply chain geared for rapid replenishment to ***pull*** stock through the system.

Given the accelerating drivers of change, and the lessons to be learned from successful pioneers, the implications are clear. Those retailers who successfully challenge the old paradigms, and look for new ways to add value from their supply chains, will be the trailblazers of the next decade.

The consumer may be the "sharp end" of retailing – but retailers have far more control over the value they create if they work their supply chain properly, starting from the raw materials suppliers all the way through manufacturing and distribution to the store shelf.