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# The State of the Retail Supply Chain 2009

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## Introduction

Over the last ten years, the retail industry has experienced major transitions. The introduction and growth of Internet-based commerce has created both new competition and a new selling channel for retailers. Big box retailers such as Wal-Mart and Best Buy have changed how America shops for products, customer expectations of retail prices, and the distribution structure of retail trade. Most importantly, distribution channel power has shifted from manufacturers, brand marketers, and franchisors to retailers. Retailers increasingly drive prices, dictate products, and wield tremendous negotiating clout.

During the same period of time, supply chain management (SCM) has experienced its own renaissance. SCM has emerged from its cost-laden, labor-intensive operational roots to a more integrative discipline that involves both strategy and activities, influences other functions, and facilitates cross-organization collaboration. As a result, C-level executives increasingly view SCM as an essential tool to compete in ever-changing, intensely contested markets and chart their organizations' future course.

In many respects, the \$4.7 trillion U.S. retail sector has led the SCM revolution. Collaborative planning, forecasting, and replenishment, vendor managed inventory, continuous replenishment, automatic identification, and are just a few supply chain innovations championed by the retail industry. They recognize the critical importance of supply chain optimization for building customer loyalty and intimacy as well as controlling costs

during the current period of flat or declining sales.

Despite the compelling link between SCM and retailing, supply chain researchers have not widely addressed it. Much of today's SCM research continues to be general in nature. The research targeted to a specific sector tends to be manufacturing-centric. As a result, the retail industry's supply chain leadership role, impact, and trends are largely under-studied.

A team from Auburn University's SCM program undertook a study of the retail supply chain in mid-2008 to address this important SCM-retail link.

## Goals and Methodology

The goal of this research is to address the knowledge gap identified by the relative lack of research in retail SCM and provide insight into the supply chain capabilities developed by best-in-class retail organizations. A slowing economy suggests this need is more critical today than ever before. We address two primary research questions. First, what supply chain challenges are of most concern to the retail industry? Second, what capabilities must retailers develop and leverage to attain supply chain excellence? Neither question has been explored in great depth by previous researchers.

## Key Findings and Discussion

Information gathered during the interviews and survey focused on the role of SCM in retail organizations, supply chain strategy, performance, and industry challenges. The results are presented below, followed by a discussion of the sup-

ply chain capabilities needed to become a best-in-class retailer that competes effectively and efficiently in the U.S. marketplace.

## Role of SCM

The interviews and survey responses reveal that retailers are expanding the role of SCM within the organization. While they are still primarily responsible for cost efficient fulfillment of store orders, retail supply chain managers are engaging in value-adding, non-traditional roles. A majority of the survey participants reported that SCM is responsible for or shares responsibility for vendor collaboration (75 percent), demand forecasting (69 percent), inventory allocation to stores (68 percent), and inventory management at stores (58 percent). Historically, these activities have been the exclusive domain of merchandising executives and store managers.

This increase in upstream and downstream engagement is achieved by breaking down functional silos and gaining support of top management. The study participants report that they have created very strong ties at the store level and are helping the merchants learn how to leverage the supply chain when negotiating purchases. They also have great access to organizational leadership. In 70 percent of the respondents' companies, the top supply chain executive reports to the company owner, CEO, or COO. Additionally, nearly 94 percent of the survey respondents agreed or strongly agreed that their CEO recognizes the key roles of SCM operations in achieving corporate success.

## Supply Chain Strategy

The rapid downturn of the economy in 2008 has caused retail supply chain executives to rethink their strategies. With sales dwindling, cost control has quickly moved to the forefront in 2009, supplanting the goals of customer service and revenue growth. More than 75 percent of the survey respondents identified either cost control or a balance (cost control plus customer service) as their focal strategy for 2009.

Figure 1 highlights the revised strategic focus of today's retail SCM organization.

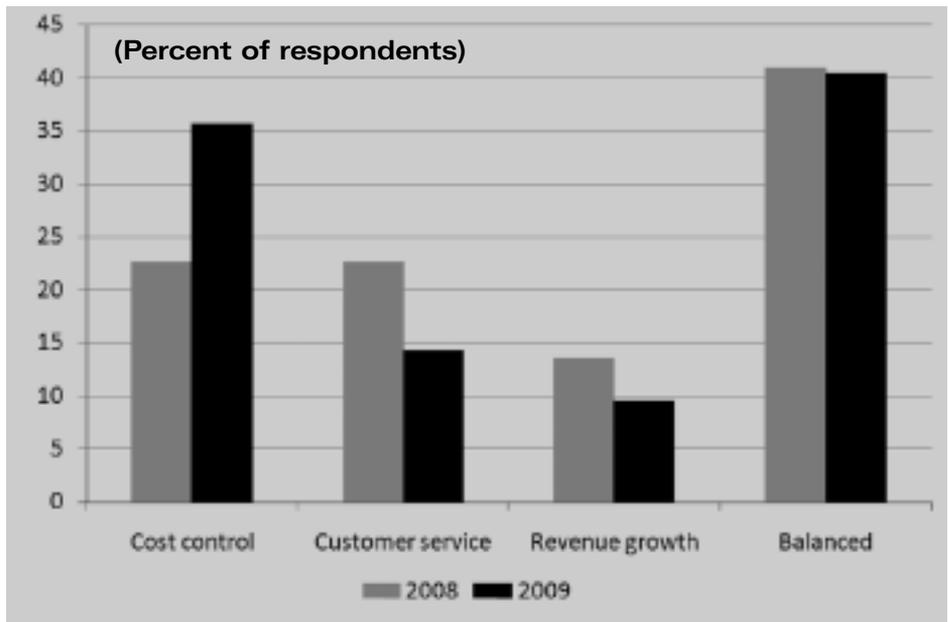
As store traffic and sales suffer, the ability to control costs is one of the best weapons to preserve profits. The retail supply chain managers are not only looking to manage fuel expenses and inventory costs, they are looking for ways to reduce overall company expenses. This often involves breaking down functional silos to reduce procurement costs or store operating expenses, even if it places additional burden on the supply chain budget. One of the supply chain executives summed up the sentiment, stating: "Sometimes we need to incur costs within the supply chain to deliver a benefit of greater value to the company."

### Supply Chain Performance

Of course, strategies are just concepts unless they are activated and monitored. The retail companies engaged in the study monitor both service and cost aspects of supply SCM performance through metrics. The most widely used performance indicating metrics include on-time store delivery, in stock availability at the store, and order fill rates from a service perspective. Inventory turns and distribution center expenses as a percentage of sales are used to monitor cost performance. Figure 2 provides insight into the performance levels of the survey participants.

While the retailers' self-reported performance versus goals is excellent, they realize that success is a moving target. They must constantly increase service and reduce costs to support the organization and seek out new metrics that provide an accurate portrayal of performance. To that end, the study participants recognize the need to move beyond functional metrics and develop cross-company measures of success. One executive stated: "My experience has taught me that if you just think about supply chain cost, you are not taking advantage of optimizing the entire end to end process from the customer's customer to the supplier's supplier." The challenge now is to move from this level of recognition

**FIGURE 1 - Strategic Focus Of Supply Chain Team**



and discussion to the implementation of cross-functional metrics.

### Industry Challenges

By all accounts, 2009 presents a number of unique challenges for retail supply chain executives. Gone, for now, are the traditional growth related concerns of distribution facility expansion, transportation capacity constraints, and labor turnover. Instead, macro-level CEO and CFO issues are at the forefront. Figure 3 reveals that supply chain executives are highly concerned about consumer confidence, global credit, and currency fluctuations and their impact on supply chain planning and decision making. Balancing cost and service in the face of these economic issues is an ongoing battle for supply chain executives. While retailers are pushing forward with

significant reductions in inventory quantity and variety on the cost cutting side, they must not forget customer expectations of availability and selection. The risk of driving away buyers must be factored into any inventory cutback plans. One executive summed up this challenge, saying: "The real focus is to lower our net inventory without compromising the in-stock experience for the customer." Hence, improvements in demand forecasting, inventory segmentation, and seasonal transitions are key priorities for retailers today as they attempt to balance these conflicting inventory requirements.

### Best in Class Capabilities

Throughout the interviews and surveys, retail supply chain executives focused on four main themes.

**FIGURE 3 - Performance Levels**

	2008 YTD Results		Percent of Respondents Meeting or Exceeding Goal
	Average	Range	
On-time store delivery	96.7%	90-99	92.9%
In stock availability at stores	94.3%	80-99	72.0%
Order fill rates to store	95.8%	88-99	78.3%
Inventory turns per year	6.5 turns	2-22	68.0%
DC cost as a % of sales	3.3%	0.5-9	88.5%

**FIGURE 3 - Key Issues and Their Impact On Supply Chain Planning** (Average Rating)

	2009 Impact Levels			
	1=Low	Moderate	High	5
Eroding consumer confidence	3.79			
Volatile fuel prices	3.38			
Global credit crisis	3.24			
Changing value of U.S. Dollar	3.18			
Rising cost of imported goods	2.97			
Supply chain capacity constraints	2.12			
Supply chain labor pool shortage / turnover	1.73			

These include: leveraging strong distribution networks, creating flexible capacity, tearing down functional silos, and developing people. These ideas and related strategies highlight best practices in retail SCM. Though no single retailer could claim excellence in all four areas, the best-in-class retailers are exceptional in at least one area and are moving forward on the others.

A major advantage of the mature big box retailers is the existence of fully-deployed, high-volume distribution networks. Wal-Mart, Target, Walgreens, Lowes and others have each built networks with enormous capacity to flow product to their widely dispersed store locations. One of the most frequently mentioned strengths of large retailers described by the executives was the cost efficiency advantage gained from this robust asset. Best-in-class retailers capitalize on logistics infrastructure investments to drive lower annual operating costs. This sentiment was effectively captured by a senior vice president of logistics, who stated: "As costs go up, we have to get much better at network utilization. We're really trying to sweat our assets."

Retailers need infrastructures that are flexible enough to handle peak demand during holidays and key selling seasons. While most successful retailers are able to handle these anticipated fluctuations, the best-in-class retailers are able to adjust capacity when unexpected demand changes occur. Flexibility is especially important in a weakening econo-

my. Multiple respondents suggested that flexibility allows an organization to meet multiple goals, even as sales are declining. "It is critical that we are able to cost effectively adjust capacity to handle changing demand and still provide the service stores and customers want," said a senior executive, summing up the importance of flexibility.

Another characteristic of best-in-class retail supply chains is direct engagement in top level planning and decision making. By being engaged in these discussions, supply chain executives are able to help the organization tear down functional silos and insular decision making. These organizations begin to view SCM as a strategic link between merchandise procurement and store operations, manage processes holistically, and give greater responsibilities to their supply chain teams. These key changes are often achieved through the development of cross-functional teams that meet frequently to ensure that everyone maintains common goals and direction. The key is C-level engagement according to one supply chain executive: "Our supply chain steering committee includes SCM leadership, the chief merchant, the CIO, the merchandise planning executive, and the CEO."

Another foundational strength of best-in-class retail supply chains is the team that keeps the product flowing to stores. Supply chain executives identified high caliber managers and employees as the key to success. Analysis of the transcripts revealed two underpinnings of the

people strength. First, the best performing retailers have developed a culture in which the majority of employees share a core belief in the mission of the organization, and are committed to helping the organization fulfill that mission. Second, the best-in-class retailers have developed formal training programs that are available to a wide array of people, not just managers and executives. A well-trained, responsive supply chain team is a key advantage and competitive barrier that many retailers seek to create. Said one executive: "We are evolving our culture, so that our associates are engaged in helping us identify where we have process failures, taking waste out, and reducing the number of defects that we produce"

### Summary

2009 has proven to be an economically challenging year for retailers. Poor consumer confidence and credit challenges have led to lower revenues, reduced profits, and a record number of retailer bankruptcies. It would be easy for supply chain executives to circle the wagons and wait out the onslaught of the economic downturn. Instead, our interviews and survey results revealed that many are taking proactive and creative steps to deal with the situation at hand. The supply chain executives see an opportunity to demonstrate the value of SCM to the organization. As one executive put it, "this is our time to shine."

Our research also highlights the steps that retail supply chain executives are taking to enhance organizational competitiveness, now and in the future. Best in class retail supply chains are working diligently to build flexible, responsive capabilities to reduce operating costs and match inventory with demand in the short run. They are also developing collaborative relationships and integrated processes with merchants and stores to efficiently and effectively serve customers in the long run. Clearly, these best in class capabilities place supply chain focused retailers in the best possible position to protect their turf now and win market share battles as the economy improves.