Linking Vendor Compliance To Retail Profitability

ComplianceNetworks
Improving Supply Chain Performance

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"…disruption experiencing firms report 33 to 40% lower stock returns relative to their competition."

The Effect of Supply Chain Disruptions on Long-Term Shareholder Value, Profitability and Share Price Volatility

Kevin Hendricks
The Richard Ivey school of Business

Vinod Singhal
Georgia Institute of Technology, 2005

Optimizing the vendor compliance process can have a profound effect on a retailer's overall profitability. Today more than ever, Chief Financial Officers are looking to their extended supply chain to improve profitability by proactively reducing or eliminating avoidable costs. A best-in-class vendor compliance process will insure a steady flow of merchandise from the vendor's docks to the consumer's hands. A disruption in the planned flow of goods can have an immediate negative impact on profitability.

Retailer's Greatest Asset

In general, suppliers/vendors are failing to meet retailers' performance expectations and the effects include lost sales, dissatisfied customers, missed margin targets, lower profits, and falling stock prices.

What insures the right product will be at the right place at the right time? A well-executed merchandising plan, accurate flow of merchandise from the vendors' docks to the retailer's stores, supply chain performance data that effectively supports decision-making to compensate for predicted vendor failures. Proper flow is an integral component of the retailer's merchandise plan. To a retailer, accurate flow enables:

-Properly merchandised stores
-Fully leveraged advertising campaigns
-Sales and margin targets are hit
-Customer satisfaction is achieved and the customer's confidence in the retailer's brand is strengthened as he or she departs the store with the merchandise they desired.

On the flipside, if merchandise flow is not in accordance with the merchandising plan, the results impact profitability:

-Stores aren't properly stocked
-Expensive advertising campaigns are wasted
-Additional labor is required to fix trouble shipments
-Unsold product must be returned to the vendor or stored
-Additional freight charges are required to remedy product shortfalls
-Sales are lost
-Margin targets are missed
-Customer satisfaction is poor.

In addition to a decline in short term profitability, the customer's confidence in the retailer's brand is shaken. Recent studies show the time compressed consumer is less likely to give the retailer a "2nd chance" than in the past. Most of us have had the experience of responding to an advertisement only to find that the featured merchandise was not yet available, or we have had to visit multiple stores to find a staple item that should have been readily available at our first stop.

Retail Profit Leaks

Most senior retail executives will tell you the key to retailer profitability is effective execution of the merchandise plan. Retailers spend millions of dollars a year on best-in-class merchandising systems to insure merchandise meets consumer demand, only to have the plan fail because a $.05 label was not properly applied to the carton, or an ASN (advance ship notice) was not received in time. Senior retail executives will tell you what keeps them up at night supply chain failures that prevent the retailer from presenting merchandise to customers when the customer is ready to make a purchase or having to markdown merchandise to induce the customer to make a purchase.

Typical avoidable supply chain profit leaks for the retailer include, but are not limited to:

-Fill rates not within tolerance (too high or too low)
-Early or late shipments
-Style/size/color substitution issues
-Carton labeling issues
-Failure to consolidate shipments and other routing issues
-Electronic data issues (missing or unreadable)
-Vendor failures to provide value-added services

All of these supply chain profit leaks can have a profound effect on retailer profitability. In their 2005 Study, professors Kevin Hendricks of the Richard Ivey school of Business and Vinod Singhal of the Georgia Institute of Technology conclude there is a direct correlation between supply chain disruptions and profitability. Their report titled "the effect of Supply Chain Disruptions on Long-Term Shareholder Value, Profitability and Share Price Volatility" concluded that

"…disruption experiencing forms report 33 to 40% lower stock returns relative to their competition".

Avoidable vs. Unavoidable Supply Chain Costs

While many retailers in the past have accepted the above supply chain profit leaks as the cost of doing business, today's profit-focused retailers are not. Today's hyper-competitive retailer environment will not allow them to. Retailers with best-in-class supply chains now classify costs in to two categories, avoidable and unavoidable.

Unavoidable costs are those the retailer must incur in order to provide merchandise in the stores. Merchandise, distribution centers, freight are all examples of unavoidable supply chain costs.

Examples of avoidable costs include late shipments, wrong carrier selection and concealed substitutions. While it is perfectly acceptable for a retailer to assume they will incur a freight bill in order to have their PO filled, most reject the notion they should incur the cost of multiple shipments per PO when they have instructed the vendor otherwise.

An unavoidable cost is not necessarily uncontrollable. Avoidable costs must be eliminated and unavoidable costs must be minimized. In order to control these costs, it is necessary to capture data relative to these costs, establish reasonable to supply chain performance requirements necessary to minimize these costs, valuate the impact of performance exceptions and the associated valuate impact on the enterprise, so as to minimize the exceptions and recover the cost.

A New Strategy for Retail Profitability

Retailers have long sought a competitive advantage by controlling unavoidable costs. Transportation Management Solutions, Demand & Inventory Planning Systems, Merchandising Systems and Labor Management Systems are just a few of the commercially available applications retailers have sought to minimize their unavoidable costs. These applications are numerous and have served the retailer will in their quest for profitability. But little attention is paid to the avoidable costs, or those due to vendor or supplier related performance issues. As stated earlier, many retailers accept these avoidable expenses as a cost of doing business.

But as competition increases and margins decrease, the rules of the game change. Led primarily by Wal-Mart, leading retailers now consider all supply chain costs, both avoidable and unavoidable to be the fair game. The strategy for unavoidable costs remains the same, optimize. For avoidable costs, some can be eliminated by working with the vendor base. When possible, the retailer's first objective should be to eliminate the avoidable costs. Through properly communicating their requirements and performance results in a clear and consistent format to their vendor base, the retailer can eliminate a majority of avoidable costs. But if the vendor chooses to ignore the terms of the purchase order or the routing guide, then the retailer's second objective is to recover the costs they have incurred. The typical manner of recovering these costs is to levy a deduction (chargeback or expense offset) from the vendor's payment that is equal to the valuated impact of the performance failure. Leading retailers reason that if they have done everything within their power to enable perfect order fulfillment, recovering avoidable cost has become a new powerful tactic in the retailer's quest for profitability.

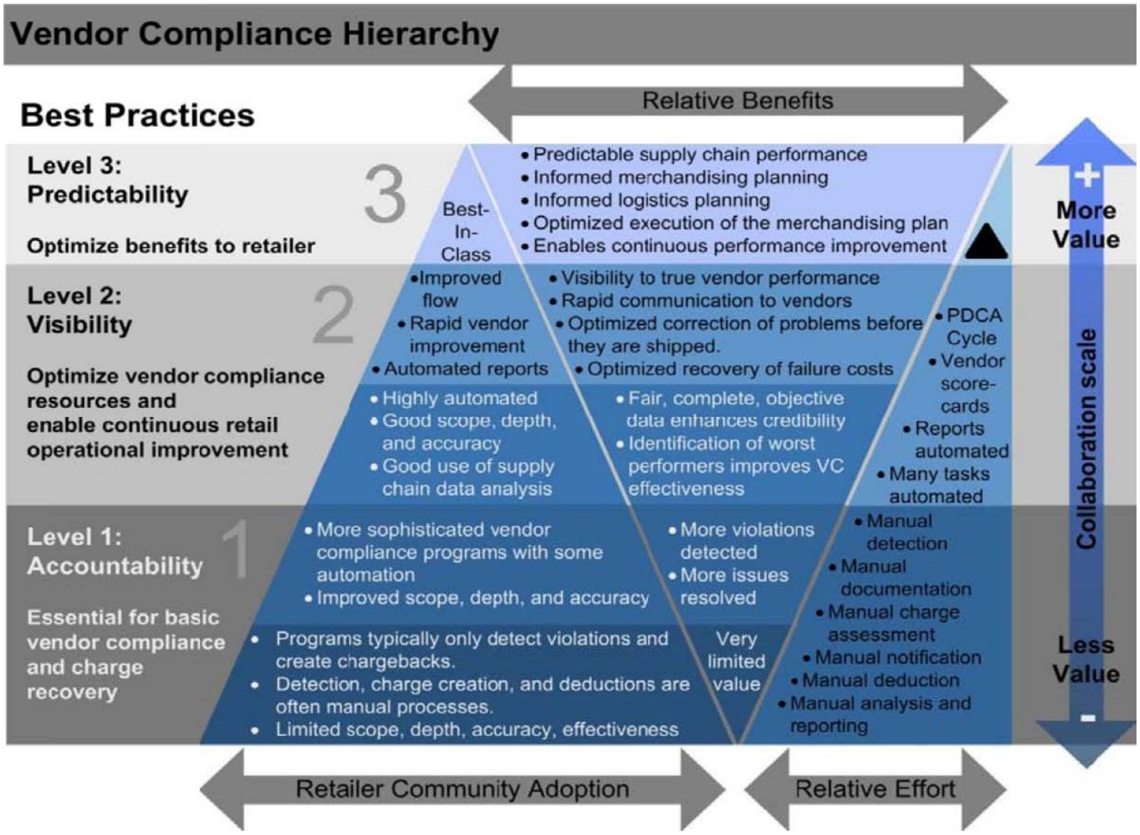
Turning Data into Actionable Intelligence

Once a retailer has committed to eliminating or recovering avoidable costs, the task of aggregating large amounts of data begins. Compartmentalized supply chain data files such as purchase orders, receiver information, EDI and ASN files, manual audits, and freight information must all be consolidated into a single location that enables the detection and valuation of performance failures. Once the process is complete, the benefits to the retailer are numerous:

-Greater communication and collaboration capabilities
-Automated detection and vendor notification of supply chain-related failures
-Better on-time delivery
-Improved fill rates
-Vendor scorecards for improved vendor collaboration
-Automated cost recovery for supply chain failures
-360-degree visibility into all supply chain operations

Profitability Outcomes of an Effective Vendor Compliance Program

In the diagram below the gray bands indicate three general levels of compliance programs. The blue pyramid on the left, labeled Retailer Community Adoption, indicates the universe of retailers with compliance programs. The relative number of retailers is indicated by the size of each blue section. The upside-down pyramid in the middle, labeled Relative Benefits, indicates the return that retailers gain from compliance programs at each level. The relative benefits are indicated by the size of each blue section. The arrow on the right indicates the collaborative value for supply chain stakeholders that can be realized as more capable and robust compliance programs are implemented.



Building a Business Case for Vendor Compliance Optimization
Leading retailers who complete vendor compliance optimization projects report immediate results. Implementation usually take 90-120 days and retailers see value the day the solution goes live. Through aggressive cost elimination or recovery, the financial impact is immediate as well. Retailers report up to a 60% increase in earnings per share 180 days after a best-in-class vendor compliance process has been implemented.

The end result is a more consistent, predictable and ultimately profitable retail supply chain. With effective implementation of vendor compliance it is possible to operate a cost-neutral inbound supply chain.

ABOUT COMPLIANCE NETWORKS

Compliance Networks is a leading provider of proven, private-cloud vendor performance solutions for retail supply chain excellence. Since 2000, our suite of solutions has enabled enterprises to improve profitability through continuous improvements in supply chain execution.

If you'd like more information visit us at www.compliancenetworks.com, drop us an email at info@compliancenetworks.com, or call us at **877-267-3671**.