

supplychainforesight 2008

FMCG & Retail Report

*Supply chain complexity and
a company's ability to manage
it, is directly correlated to
its success in the marketplace.*

Academic Partner



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Survey conceptualised and initiated by



Barloworld
Logistics

Introduction

The supplychainforesight report

The **supplychainforesight** report for 2008 seeks to demonstrate clearly and decisively what we have been arguing for five years now: that there is a significant correlation between supply chain reform and business success on many fronts, including both growth and profitability. In this year's research we have sought the answer to the key question: *are South African companies who respond to the challenges of globalisation through strategic supply chain reform more successful than those who do not?*

Correlating Supply Chain Reform and Business Success

In 2003 Deloitte produced a report in their series The Global Benchmark Study, entitled "Mastering Complexity in Global Manufacturing: Powering Profits and Growth through Value Chain Synchronization". The report shows that 'companies seeking to exploit global market, supply chain and engineering opportunities are hitting an invisible but nonetheless debilitating wall: mounting complexity across the value chain, and it is bound to get worse.'

Deloitte coined the term 'complexity masters' for the small group of companies – 7 percent of their sample group – who have overcome this complexity in their value chains by synchronising customer, product and supply-chain-related strategies and operations while leveraging strengths in collaboration, flexibility and visibility. In Deloitte's estimation these reforms helped the 'complexity masters' to generate up to 73% higher profits, as well as growth rates that were markedly better than other companies studied.

In this year's **supplychainforesight** study, we seek to present a framework for understanding the urgent challenges facing South African supply chains now – taking our lead from the Deloitte study, which did not deal with Africa at all. We look at the need to deal with the tsunami of globalisation

and find competitive advantage in it, and the growth and profitability that are available to companies plotting this route successfully. We also provide a specific framework for understanding the link between business success and supply chain innovation in the SA market, and a view of supply chain capabilities and the means to deal strategically with complexities brought about by globalisation. Our research thus tests the Deloitte theorem in the value chain context of South Africa's private sector specifically, and points to ways in which the private and public sectors in SA can collaborate to enable more successful supply chains for both.

A Groundswell of Executive Participation

One hugely encouraging factor this year was the record level of participation. Over 400 senior executives in some of South Africa's largest companies responded to our questionnaire this year, almost double the participation of last year's study. Most of these responses again came from major corporations with global operations, and levels of participation by CEOs and General Managers were also at record levels – up to 29% from 18% last year.

There is also a huge increase in the participation of logistics middle management, to 16%, up from 8% last year. As far as the retail sector is concerned, almost 90% of

participating companies earn over a billion rand in annual turnover, with 56% of these at over 5 billion. For the FMCG sector 26% of companies are large at over a billion in turnover, with a further 32% earning over R5bn. The size of these companies in the sector suggests not only the authoritative nature of the outcomes, but the value provided by **supplychainforesight** as a benchmarking and information tool.

The Capability and Complexity Question

In order to understand the place of SA companies on the global supply chain competitiveness map, we began our research this year by asking several questions of company leadership and supply chain executives designed to build on and modify the Deloitte approach to the 'complexity masters'. We have been able to provide a clear answer to the question about the correlation between supply chain reform and company growth and profitability by mapping the co-ordinates of SA businesses on a grid between measures of supply chain capability and the extent of the complexity faced by their supply chains.

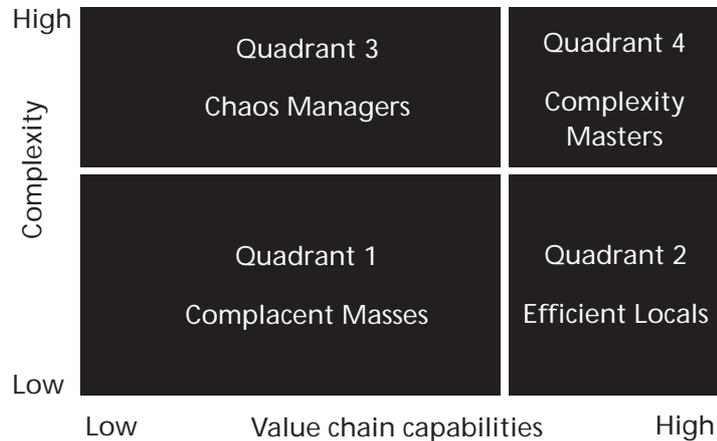
In the industry analysis which follows, we have dealt first with the retail sector and then separately with the FMCG sector.

To map the grid positioning companies across the measures of the complexity of their value chains and the capability of these companies to deal with that complexity, we asked several questions.

On the complexity axis, we asked in which regions companies performed the business activities of sales and marketing, procurement, manufacturing and engineering, in order to gain a picture of the nature and extent of globalisation for the business, and by extension the complexity of the value chain.

On the capability axis, companies were rated in terms of their relative competitiveness on factors such as product innovation, time to market, manufacturing flexibility, logistics effectiveness and supply chain reliability. The business success indicator was then determined when companies were asked to rate their success relative to their competitors in areas such as profitability, revenue growth, market share growth and customer retention.

We then plotted scores for complexity of the value chain against companies' ability to deal with it, and were then able to organise companies into four different quadrants. We examined how many of the companies falling into each quadrant had reported having higher success measures than their competitors. The measures along the two axes, correlated with these success measures, enabled us to plot two grids, each into four quadrants, which had the following distribution:



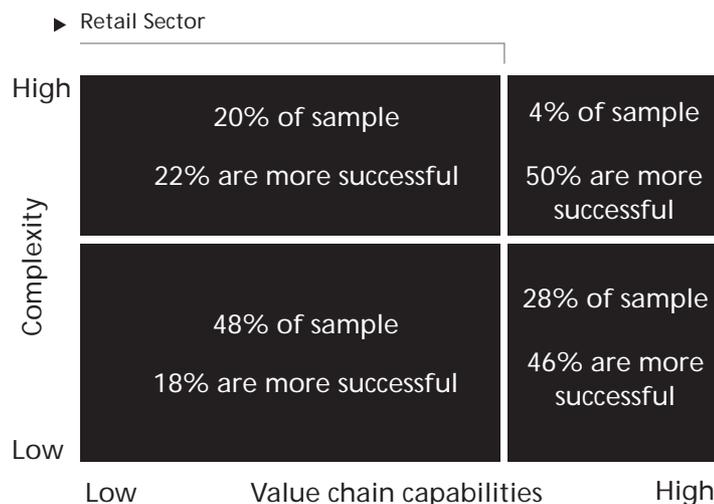
In the general supplychainforesight study this year, our hypothesis was proven correct – that is, that companies who have complex, usually highly globalised, supply chains and who have the capability to manage them, are far more successful than those companies who do not. These companies we placed in our 'quadrant four'.

Companies who have neither significant complexity nor capability are in quadrant one, and in the current global competitiveness climate, are seriously at risk. Those in quadrant two are businesses which have strong capability in their supply chain but are relatively

less complex or globalised. These show the next highest degree of success after quadrant four, and are well positioned to move into quadrant four. Finally, companies in quadrant three have much complexity but relatively little capability to deal with it. Like quadrant one but for different reasons, these businesses are also at risk.

Capability and Complexity in the Retail sector.

The retail sector, as one would expect due to the nature of the business, shows high levels of complexity, particularly with respect to global procurement.



FMCG & Retail

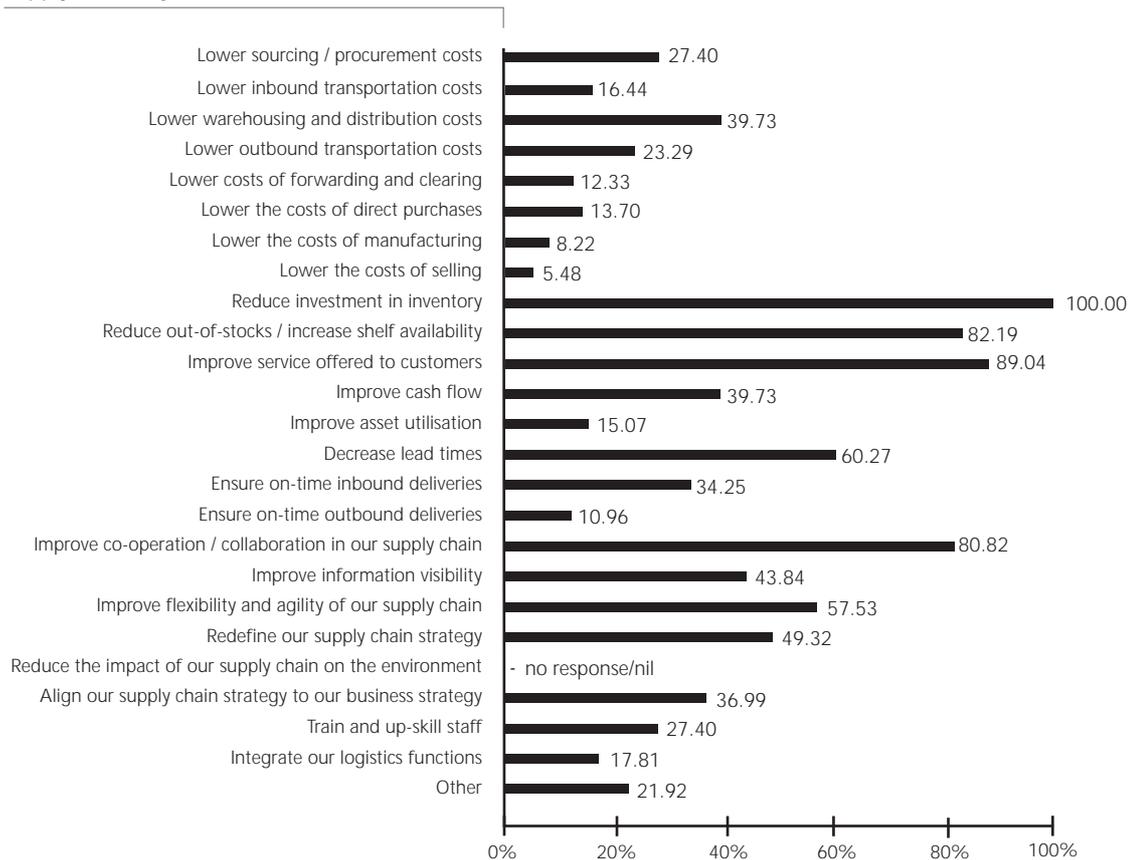
The relative measure of companies in the sector with their competitors largely confirms the overall hypothesis, and demonstrates where the perceived strengths and orientation of the retail supply chain lie. The sector follows a similar distribution to the total sample, with

slightly more companies in relative terms (28%) falling into the 'high capability, low complexity' quadrant two, compared to the total sample (19%). A similar success rate is attested to by this quadrant to that by the total (46% for retail, 48% for the total).

It's evident from this that the driver of success in the retail sector is a focus on matching the current levels of supply chain complexity to the capability and strategy to deal with it.

Retail Objectives and Challenges

► Supply chain objectives: (Retail)



The differences between the objectives of the retail supply chain for the coming year and those of our total sample group are instructive and fairly marked. For retail, as might be expected, reducing inventory is the overwhelming and unanimous focus, one that was so for only 71% of the total sample.

chain'. Overall 81% of the retail group rated this a key objective, compared to 53% of the total sample.

Some other areas of focus for retail supply chains for the coming year were in marked contrast to the total sample. These included a focus on improving flexibility and agility of supply chains in the sector (58% versus 35%), and a wish to redefine the supply chain strategy (49% versus 26%).

We might ask the question whether these moves to redefine and make the supply chain more responsive indicate a new willingness to collaborate in an environment not noted for such willingness in the past, or a movement of the receiving bay to new distribution centres?

Complementarily to these objectives, the sector has a lower focus on cost reduction overall than the total sample.

There is also a marked increase over the total sample for the objective of 'improving co-operation/collaboration in our supply

Procurement is rated by only a very low 27% of the sample, versus 81% for the total sample; lower inbound transportation costs by only 16% versus 43%, and lower warehouse and distribution costs by 40% as opposed to 61% for the total.

What these shifts in emphasis in the sector's supply chain planning probably indicate is that the redefinition in supply chain strategy is about the overriding goals of improving customer service and the reduction of out-

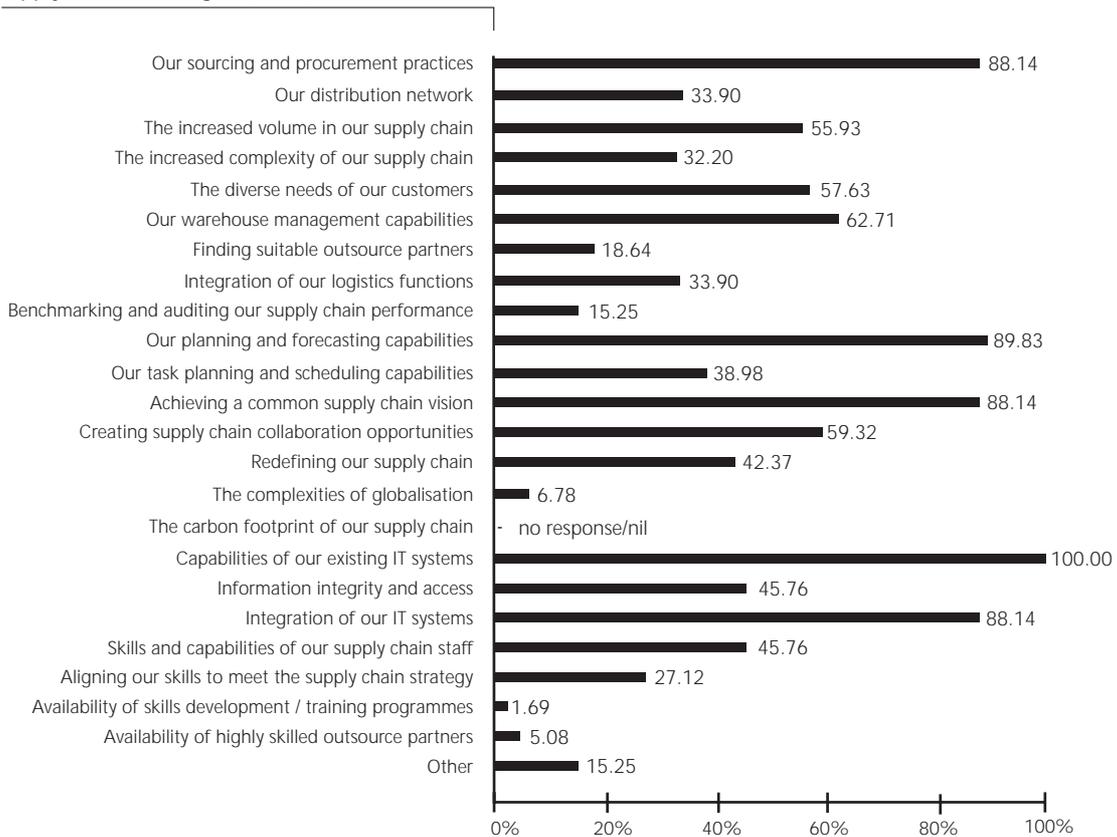
of-stocks. As a result, the focus has shifted, relatively, away from cost reduction.

As far as the challenges to meeting these objectives are concerned, the stand out difference between the sector and the total sample is in 'the capabilities of existing IT systems', at 100% versus 67%. This makes sense for a sector centrally concerned with the balancing act between availability and stock outs, and also, as we know in the local sector, with many retail chains undergoing a

shift from decentralised deliveries direct to stores to regional distribution centres, the management of which is enabled by IT.

Also among the challenges that were more distinctly retail, achieving a common supply chain vision ranked at 88% versus 48% for the total sample; warehouse management capabilities were at 63% versus 41%, and creating collaborative opportunities were at 59% compared to 40%.

► Supply chain challenges: (Retail)



FMCG & Retail

Outsourcing in the Retail sector

The retail sector is markedly more likely to use certain types of logistics service providers than the total sample.

They are higher users of 4PL service providers, at 21% compared to 16%, and also of supply chain consultants, at 36% compared to 24% for the total sample.

The reasons for these outsourcing choices are given as 'to improve performance'

(48% versus 36%) and 'to gain advantage over competitors' (34% versus 20%). It is notable that these reasons for outsourcing are shared with the most successful quadrant in the total sample, quadrant four companies, who successfully combine capability and complexity in their supply chains.

The sector is comparatively less interested in outsourcing for cost reduction, at 23% versus 32% for the sample.

Retail Conclusions

It's clear that the retail sector are looking to reform their supply chains for service improvement, and are, perhaps as a consequence of this choice, not aware, or concerned, with the cost saving potential of supply chain reform.

The fact that collaboration surfaces once again as an objective may indicate that it continues to be a holy grail that is proving elusive. As it turns out, there remains great opportunity to open or develop dialogue with a very capable FMCG sector in order to drive these desired reforms.

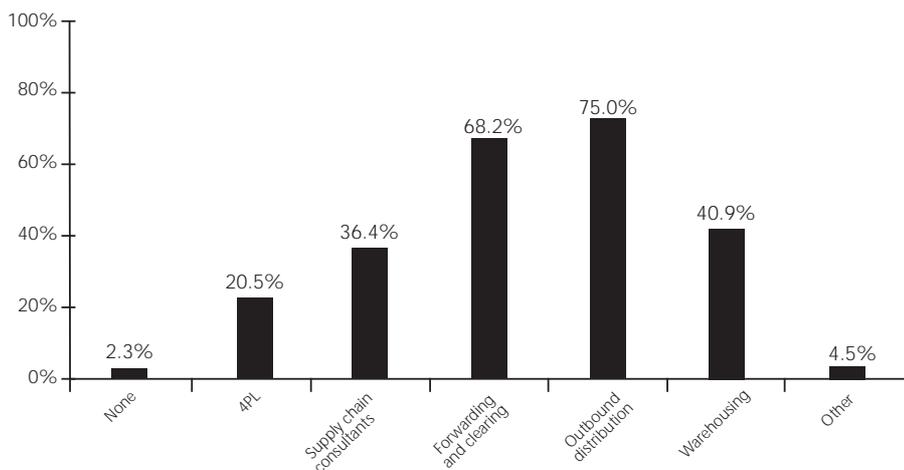
Capability and Complexity in the FMCG sector

The distribution in the FMCG sector in terms of our capability and complexity measures differs in subtle but significant ways from the overall sample.

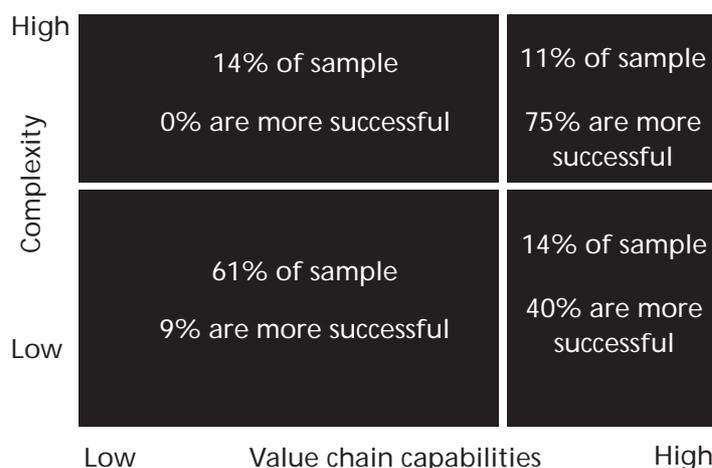
The overall picture of the most successful companies in FMCG relative to their peers remains those who master both capability and complexity. As with retail, there is a marked increase in the absolute measures of complexity and capability in the industry, compared to other industries as opposed to the relative measures of comparison to their own competitors. The worst performing quadrant in the sector is those who have complexity without capability.

This paints a picture of a local FMCG sector which is relatively sophisticated when compared to other industries, but nonetheless is challenged by the demands of a varied and increasingly complex globalised supply chain and customer base.

► What types of logistics service providers does your organisation currently use?

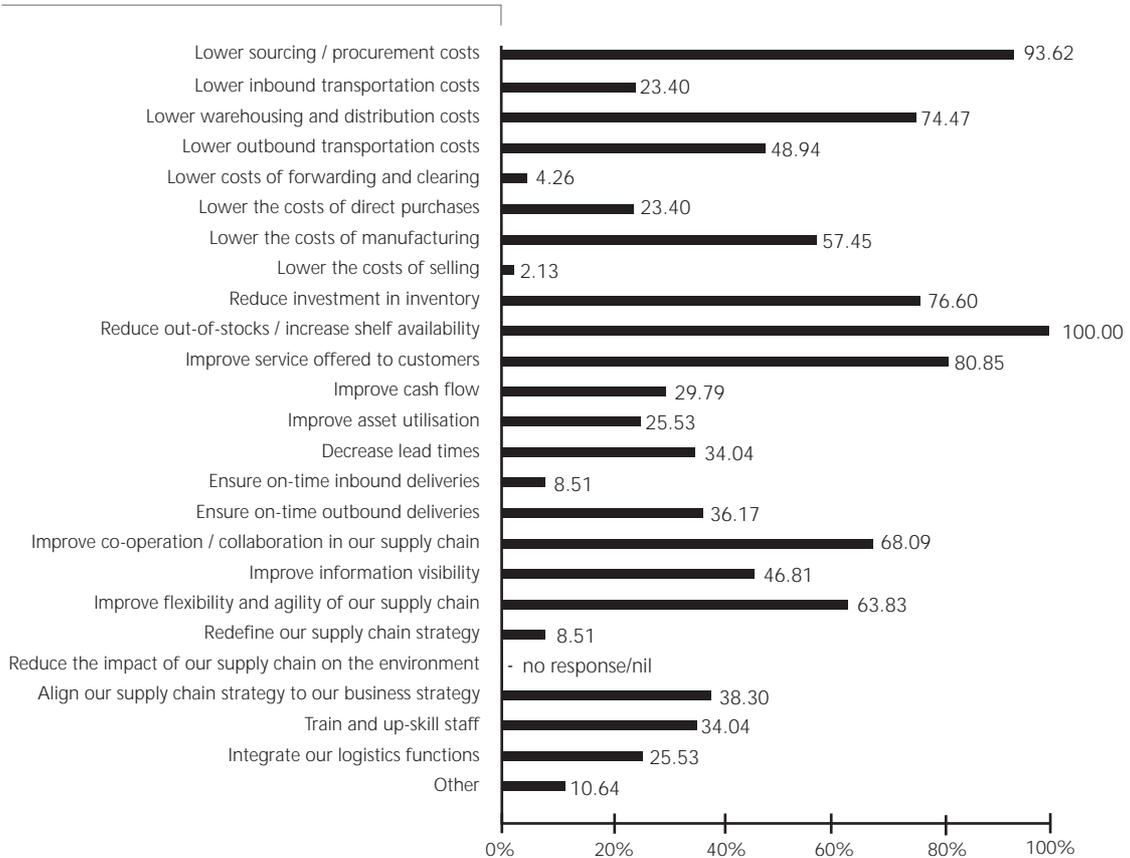


► FMCG Sector

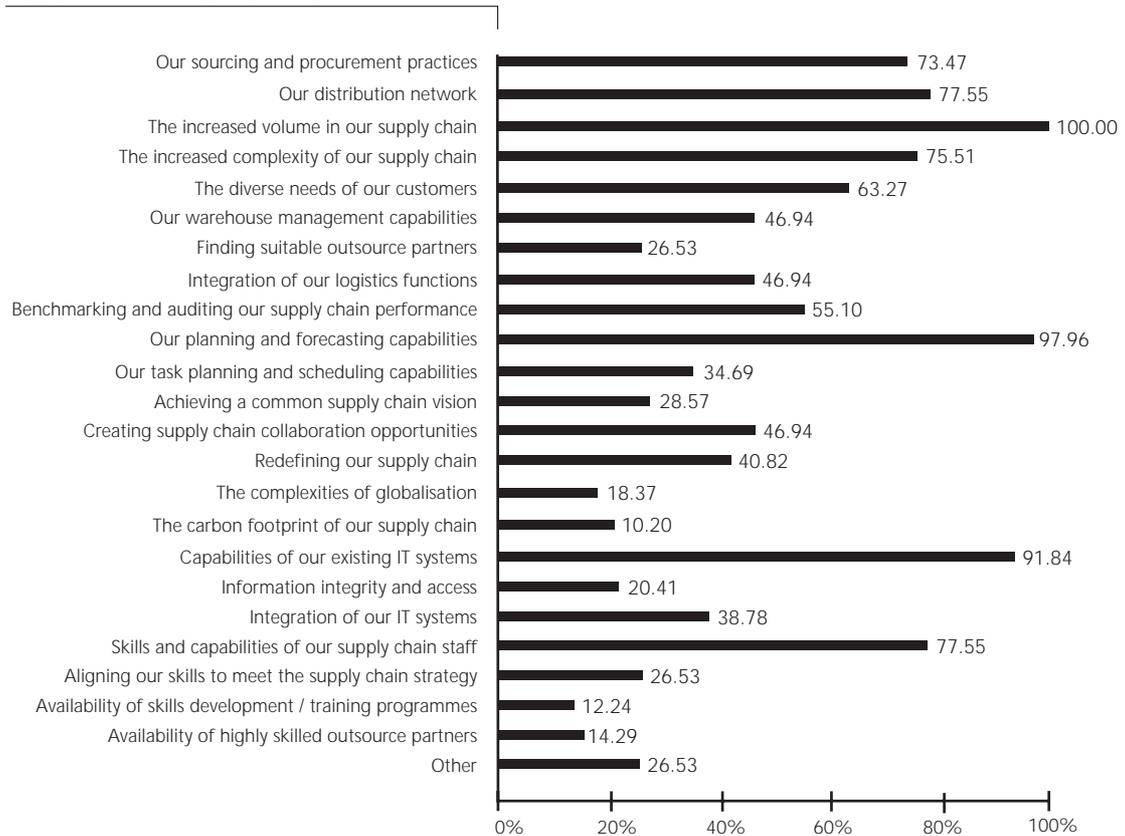


FMCG Objectives and Challenges

► Supply chain objectives: (FMCG)



► Supply chain challenges: (FMCG)



FMCG & Retail

The objectives for the FMCG sector focus entirely on what they believe are the priorities for their customer base, the retail sector. Thus 'reducing out-of-stocks/shelf availability' is the number one objective, at 100%, followed by lower sourcing/procurement costs' at 94% and 'improved service to customers' at 81%.

While these priorities differ from their retail partners, the same priorities as retail in 'improving co-operation/collaboration' is still higher for FMCG than the total sample at 68% compared to 53%, as is 'improving flexibility and agility of supply chain' (64% versus 35%). A marked difference from the retail sector is in the objective of 'redefining supply chain strategy', which drops to 9% from 46% in retail.

The challenges for FMCG really reflect both the attempt to keep up with increasing complexity and varied demand, as well as the attempt to align what they feel is a solid supply chain strategy with that of their retail partners.

The chief challenge, for 100% of the sector, is thus the increased volume in their supply chains, followed by planning and forecasting capabilities, which follows the total sample picture. Like retail, and perhaps because of the challenge retail faces in this, the capabilities of IT systems rate highly as a

challenge (92% versus 67% for the total sample). Complexity too rates much higher than the total sample as a challenge, with 76% versus 59%.

Outsourcing in the FMCG sector

As with retail counterparts, FMCG uses more 4PL service providers and supply chain consultants than the overall sample (respectively, 26% versus 16%, and 36% versus 24%).

The main reason given, however, unlike retail, is to reduce costs (48% versus 32% of the total sample). This is followed by performance improvement and to gain competitive advantage. The cost reduction focus may reflect the historical reality of cost pressure placed on suppliers by the retail supply chain.

Where to from here for FMCG and Retail?

Overall, the FMCG/Retail sector, in absolute terms, is a very complex and capable industry. Even given their sophistication, our hypothesis that those companies who master both complexity and capability will outperform their competitors holds strongly.

The worst performing quadrant in the analysis was that of the FMCG 'high-complexity/low capability' quadrant. This shows that when

a globalised supply chain becomes too complex for the capability of the business, service levels and business success both suffer.

In comparison to other industries the attitude to supply chain reform and objectives, as well as to outsourcing in particular, the whole sector behaves more like the 'complexity masters' quadrant than most other industries. It appears that FMCG would welcome being led by the Retail sector in using collaborative supply chain reform to help them with mounting complexity. Collaboration and co-operation are still on both agendas as an objective, so regular mutual feedback is obviously vital. Extending such a consultative process to the public sector can only help supply chain reform efforts overall.