2016 THE STATE OF RETAILER-VENDOR SUPPLY CHAIN RELATIONSHIPS

A Benchmark Study

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The consumer goods to retail supply chain has clearly been the most prominent and quite arguably the most important sector of the supply chain for decades.

Just consider how many supply chain developments and innovations have come from this sector, such as the UPC code, Efficient Consumer Response (ECR), continuous replenishment, Quick Response, Collaborative Planning, Forecasting and Replenishment (CPFR), the EPC RFID tag and more.

Of course, many of the companies most associated with supply chain excellence are either consumer goods manufacturers or retailers, including Walmart, Procter & Gamble, Unilever, Amazon and many others.

Many of the initiatives listed above have some level of collaboration between retailers and manufacturers at or near their center. There is nearly universal agreement that there is significant opportunity for both sides to reduce cost and improve customer service by working more as true supply chain partners in meeting common goals, versus acting as manufacturers and retailers independently pursuing their own strategies and objectives.

In fact, with increasing supply chain efficiency in their own operations, some retailers and especially manufacturers contend that the next generation of supply chain improvements must come from collaborative efforts, working “the seams” of the entire consumer goods to retail value chain.

As an example, consumer packaged goods giant Unilever has opened a supply chain innovation lab to look for just those kinds of collaborative opportunities with its retail customers, using supply chain network

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design tools to work with those retailers to see how thinking as one could lead to big improvements in product flows and inventory levels.

> "What is the state of retailer-manufacturer supply chain relationships today? Are they getting better or worse – and why?"

All of which led *SCDigest* to think of several critical questions: What is the state of retailer-manufacturer supply chain relationships today? Are they getting better or worse – and why?

In pursuit of such insights, *SCDigest* recently conducted a survey of retailers, consumer goods manufacturers and others (academics, consultants) to benchmark where things stand in the consumer goods to retail value chain.

Importantly, we believe this survey can be repeated every other year to track progress – or backsliding – over time.

The survey was promoted to *SCDigest* readers, along with support from RVCF (Retail Value Chain Federation), which encouraged its members to participate.

In addition, the research was supported by Compliance Networks, a provider of retail vendor performance management solutions.

All told, *SCDigest* received survey responses from 50 retailers, about 200 consumer goods manufacturers, and 80 from the "other" category. That included many leading companies, a sample of which are listed below.

Table of Participants

Abbott Nutrition	Bonton Stores	Hanes Brands	Perrigo
Ace Hardware	Brother Int'l.	HEAD Penn	Polar Electro
AutoZone	Buckle	Johnson & Johnson	REI
Barnes & Noble	Carhartt	Levi Strauss	Stage Stores
Bentex	Central Garden & Pet	L'Oreal	Stanley
Big Lots	Columbia Sportswear	LVMH	Stein Mart
BISSELL	General Mills	Mohawk Home	The Apparel Group
Bonded Apparel	Hachette Book Group	Nike	Uniliver

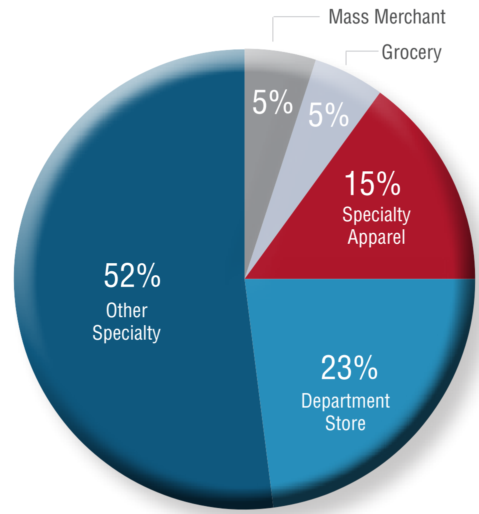
Respondent Profile

Participation by both retailers and manufacturers was broad. On the retail side, just over half of respondents were from the "other specialty retail" segment, as shown in the chart below. Department stores made up the second biggest segment, with 23% of the total, followed by specialty apparel (15%) and then mass merchants and grocers, both at 5% of the total.

From a size perspective, again there was a very broad mix, with the single largest participation from retailers with sales of between $11 and $49 billion (25% of the total), followed by the $3-5 billion segment at 22.5%. Smaller retailers (under $500 million in sales) were just 7.5% of the total.

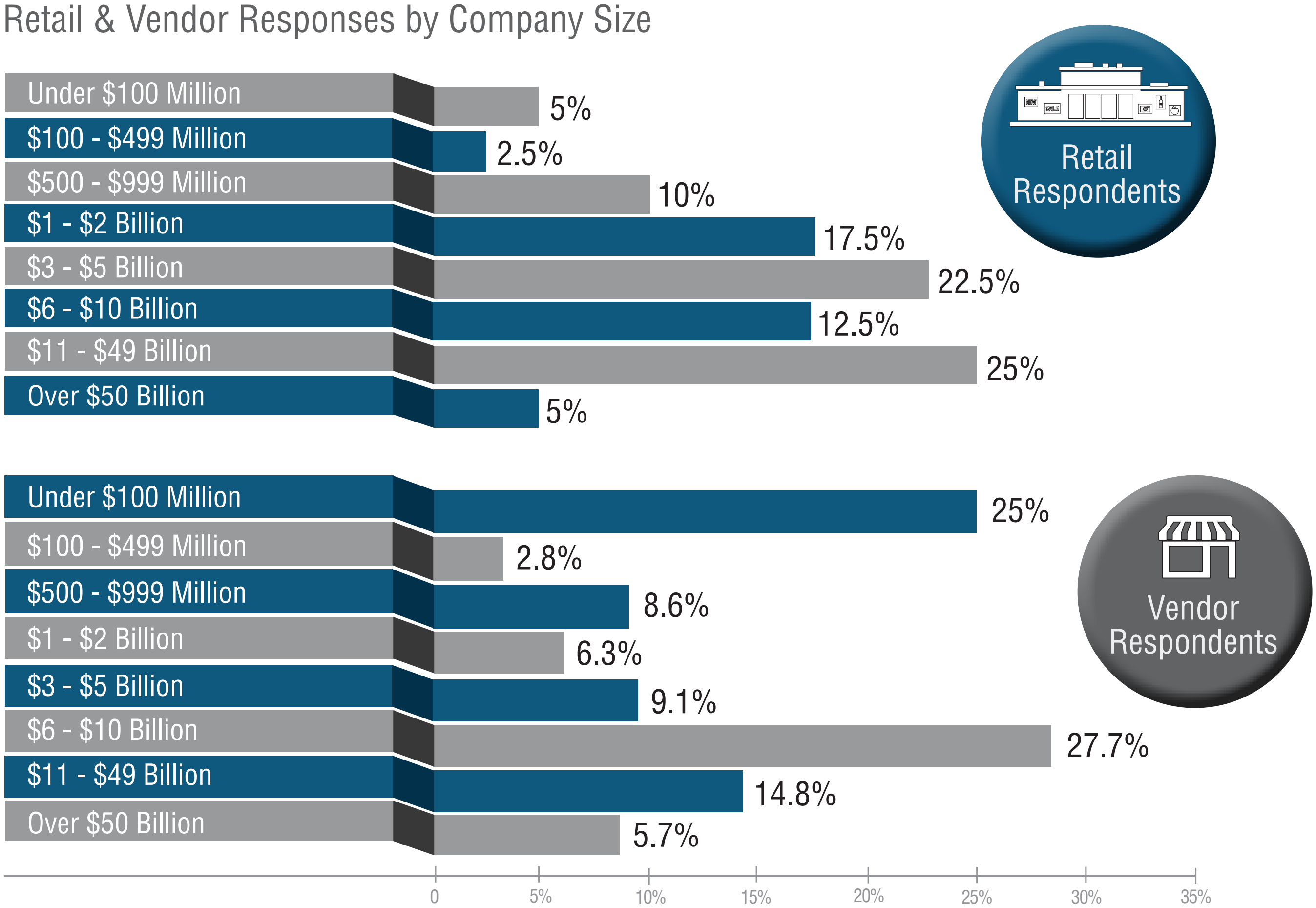
There was a similar story on the vendor side. The sectors represented were so diverse, from food to toy manufacturers, that a chart depicting the spread would be of comparatively little value. Literally every consumer goods sector was represented.

Retail Respondents by Segment



From a size perspective, it was a nice mix, with almost 25% representing smaller vendors under $100 million in sales, while a combined 17% have annual sales of $6 billion or greater.

Retail & Vendor Responses by Company Size



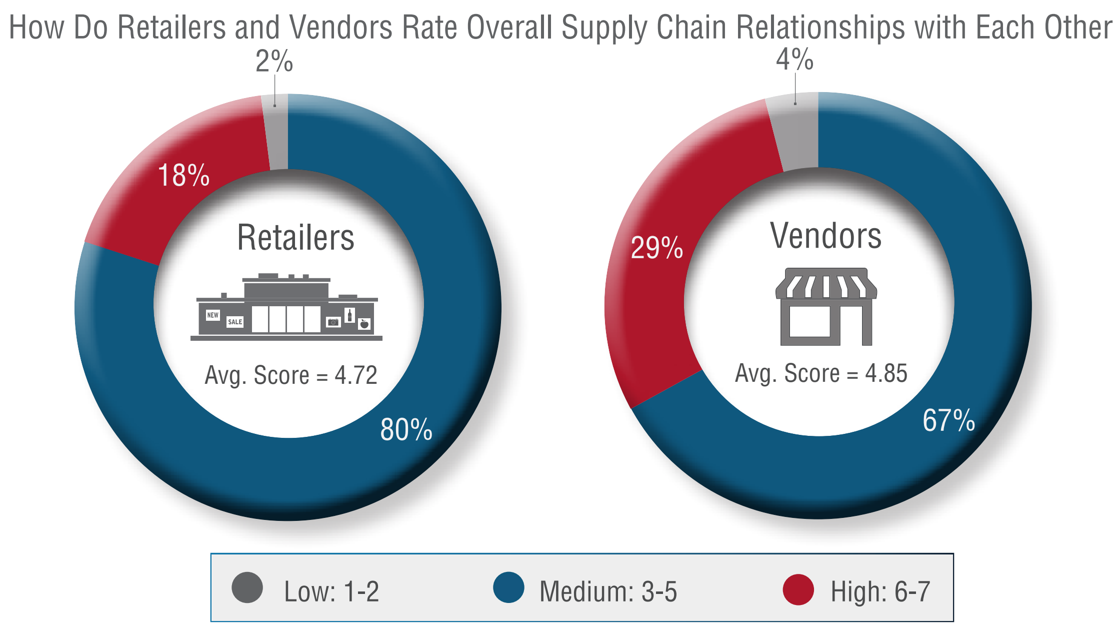
Survey Results

The survey in many cases asked very similar questions to both retailers and manufacturers to enable comparisons between the two sides on a variety of issues.

That began with questions on how retailers and vendors rate their current relationship with the other side from a supply chain perspective, on a scale of 1 to 7, with 1 being the poor and 7 being the best relationships.

To graph the results, *SCDigest* grouped responses of 1 or 2 as “low,” 3 to 5 as “medium,” and 6 and 7 as “high,” an approach we have often used in the past for other benchmark studies. As shown below, a full 80% of retailers responded in the “medium” category, versus 18% the high category and just 2% in the low category. The retail average was 4.72, solidly above the mid-point score of 3.5.

Perhaps surprisingly, vendors had a much higher percentage (29%) in the “high” category, with 67% in the medium category, and again just 4% with “poor” responses. The average of 4.85 was slightly higher than the retail score and again solidly above the mid-point of 3.5.

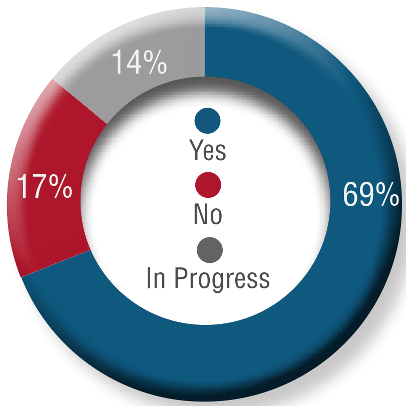


So from this data, it is fair to say that both retailers and vendors are largely satisfied with their overall supply chain relationships with the other side of the equation.

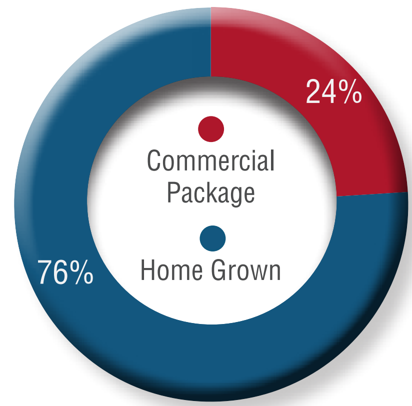
We next moved to the subject of retail compliance programs, certainly over time a source of contention between retailers and manufacturers. Clearly, this practice is firmly embedded in retailers, with 69% saying they currently have a formal vendor compliance program, and another 14% saying they have a compliance program in progress.

Many smaller retailers may believe they lack the clout to enforce vendor compliance programs, but that actually is generally is a misperception. Compliance Networks, for example, has several smaller retailers as clients, demonstrating with the right technology support retailers of almost any size can put together a program.

Do Retailers have a Formal Vendor Compliance Program?



Type of Technology Support for Compliance Program



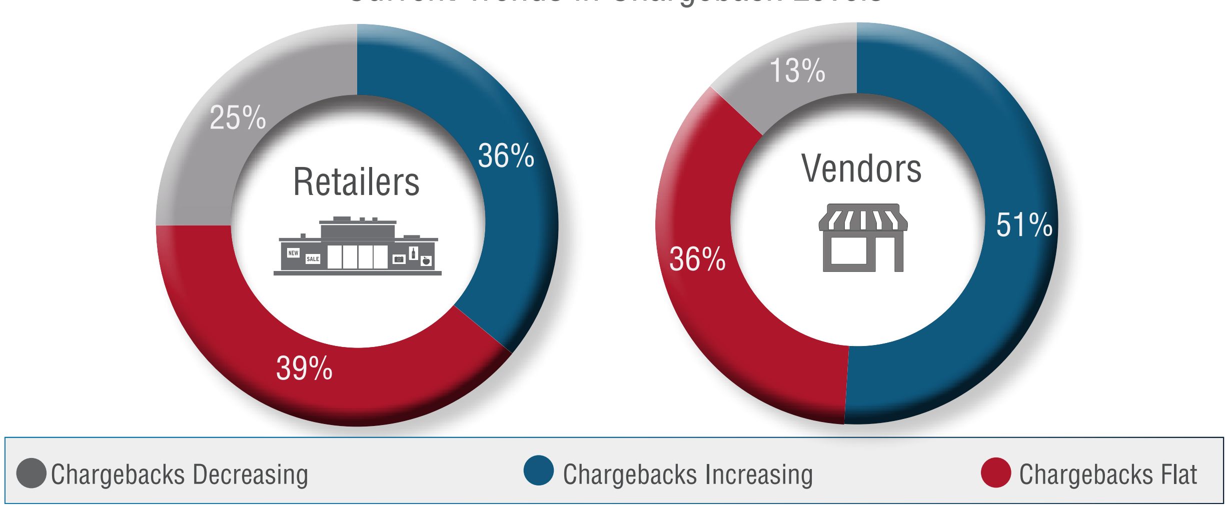
For the retailers that do have formal compliance programs, just over three-fourths of them are using home grown technology to manage the program, versus 24% using some form of commercial package, though we will note that historically retailers with home grown systems have often struggled to devote the IT resources needed to maintain and expand those applications.

In terms of how their compliance programs are managed, just 5% say they rely only on chargebacks, versus 21% of retailers that say they don't use chargebacks at all and rely instead on vendor counseling only. Auto parts retailer Pep Boys is an example of company that has moved only just a bit on the chargeback path, even though it operates a sophisticated compliance management system (from Compliance Networks), preferring in general to use counseling over penalties.

The vast majority of retailers, 74%, use a combination of chargebacks and counseling, which is a positive sign, since we can assume the counseling aspect is strongly geared towards eliminating the issues that are causing the chargebacks (i.e., improving supply chain performance), rather than having a focus primarily on the chargeback fees.

Interestingly, we next took a look at perceived trends in chargebacks from both a retailer and vendor perspective. Thirty-six percent of retailers and 51% of vendors say the current trend is that chargebacks are increasing, versus 25% and 13%, respectively, that say that chargebacks are decreasing. Thirty-nine percent of retailers and 36% of vendors say that chargebacks are staying relatively flat.

Current Trends in Chargeback Levels



We received some interesting comments on compliance trends from both retailers and manufacturers. On retail side, one respondent noted that "Vendors simply continue to struggle to deliver on time with the right labeling, documentation, etc."

Another commented that "Some vendors are improving, but technology is allowing us to find more [violations] to replace those improvements." But another retailer said chargebacks are on the decline. "Our chargeback dollars are down," the retailer said. "Vendors see dollars deducted within a scorecard. The assumption is that they could lose business." Along the same lines, another retailer commented that "Increased communications to the vendors on issues and scorecarding seem to be driving some portion of the improvement" in deduction levels.

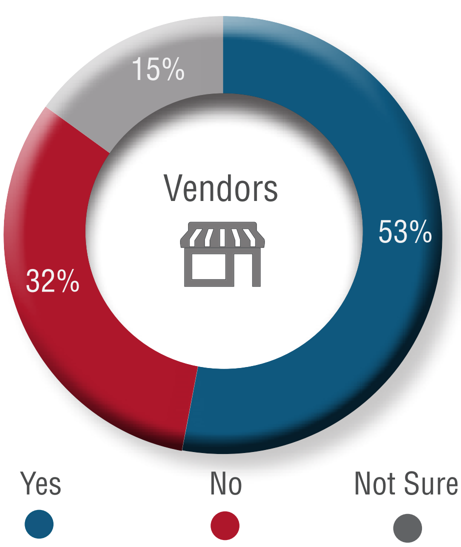
On the vendor side, one company that said it is seeing rising chargebacks observed that "More programs and greater scrutiny of the data and administering of the chargebacks [is a factor]. Carrier capacity is driving chargebacks with poor on time performance." That is an interesting point.

"Retailers have largely increased their non-compliance fees," one vendor observed. "Further, the retailers have added many new compliance initiatives relative to e-commerce." Finally, one vendor said "The trend is up, and it seems to be a profit center for retailers."

That sentiment is certainly a popular one among many vendors, and in some cases is probably accurate. But the best retailers are instead pegging chargebacks based on what the error actually cost them to mitigate, and seek to use compliance to drive out errors and improve supply chain performance.

Some argue that there is a certain pointlessness to chargebacks, in that vendors will find some way to recoup these costs, either in terms of product pricing or reduced promotion program funding. That view is somewhat supported in our data, in which 53% said they believed chargeback costs are considered in product pricing and promotional spend, versus 32% that said it was not a factor (15% were not sure).

Do Vendors Recoup Chargebacks through Prices or Changes to Promotions?

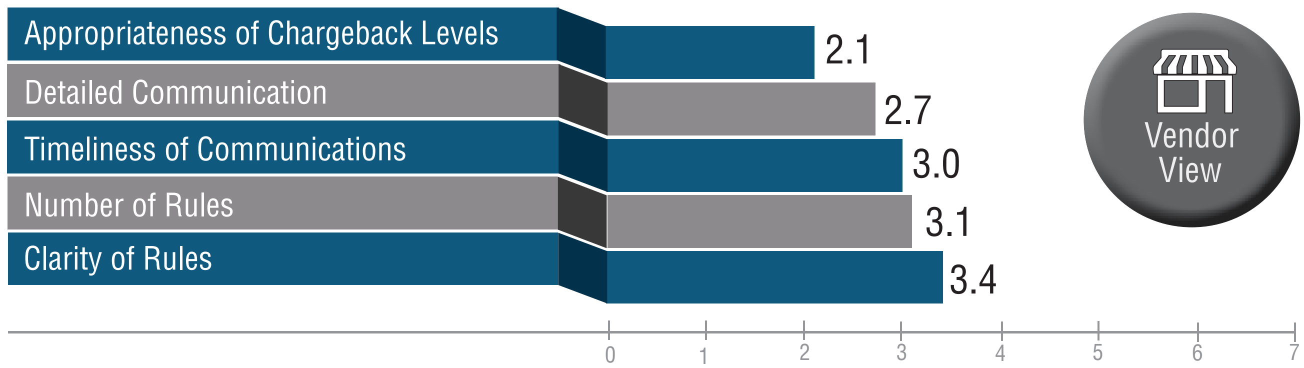


SCDigest's view is that this is a short-sighted perspective. Even if vendors are able to claw back some or all of their chargeback fees through one of these methods, it would obviously be better to avoid the chargebacks and use those reduced costs to improve profit margins, reduce sell prices to gain market share, fund additional promotional programs, etc.

We then asked vendors to rate various aspects of retail compliance programs, as shown in the chart below, based on having vendors rate each element on a scale of 1-7, with 1 being the least satisfied and 7 being the most satisfied.

The news is not good from a vendor perspective, with all five elements scoring below the mid-point average of 3.5, led by "appropriateness of chargeback levels," with a score of just 2.1.

Vendor Views on Elements of Retail Chargeback Programs



No one likes paying fines, so this result is not surprising. The key question is whether the perception is valid. Research from Compliance Networks in the past has shown that in fact there usually is a wide spread between retailers in terms of charges for the exact same error or offense, providing some support for the notion that chargeback levels can in some cases be somewhat arbitrary.

In general, we again repeat that chargeback levels should match the cost of the error to the retailers. In terms of something like the need to re-ticket items because they were mis-priced, that calculation should be fairly straightforward. But what is the cost of a late shipment or poor fill rates for a PO? Those are harder questions to answer, as the "cost" is primarily related to lost sales. Even "problem shipments" from vendors that must be reworked in some fashion in the retailer's DC can result in lost sales in addition to the rework costs, as there can be delays getting that merchandise to stores.

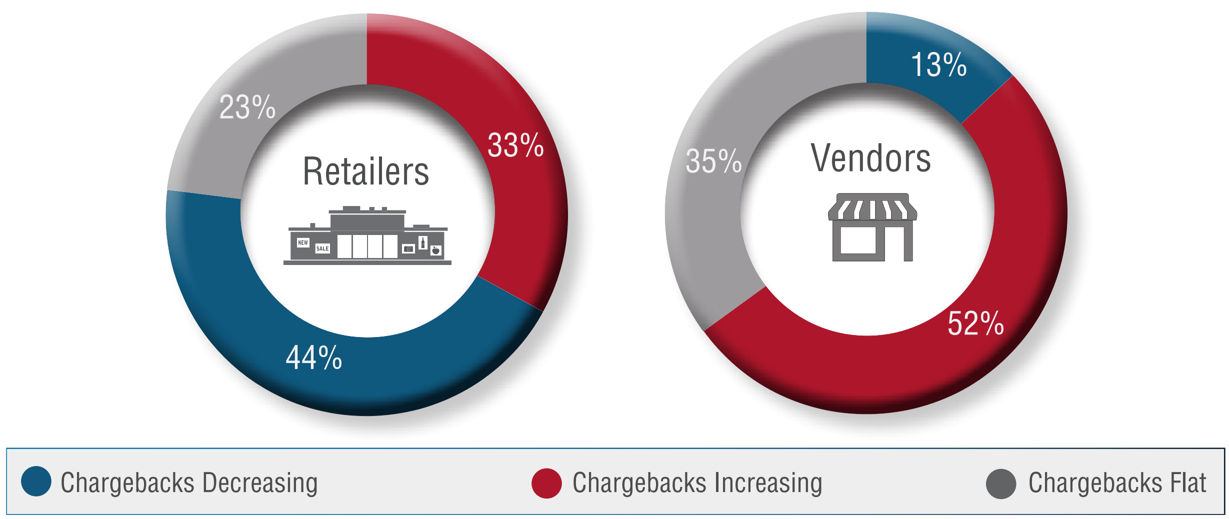
What's more, Compliance Networks' research has also led to it to recommend that retailers should generally be near the mid-range of chargeback levels across retailers. Why? At the high end, chargebacks may lead to problems with vendors believing the deductions are unfair. But interestingly, retailers should not generally be at the low end of the scale in most cases either, because that may lead a vendor say low on merchandise to short that retailer rather than another that would levy a higher chargeback for the failure.

The second highest complaint from vendors, with a score of 2.7, has to do with lack of detailed information about what actually triggered the chargeback and how the deduction was calculated. This is understandable - if a vendor is unclear as to why it received the fine, it will question the charges and distrust the system. We will note, however, that one benefit of leading compliance management software packages is that they can automate and improve this communication process, leading to better understanding by vendors of the reason for the violation.

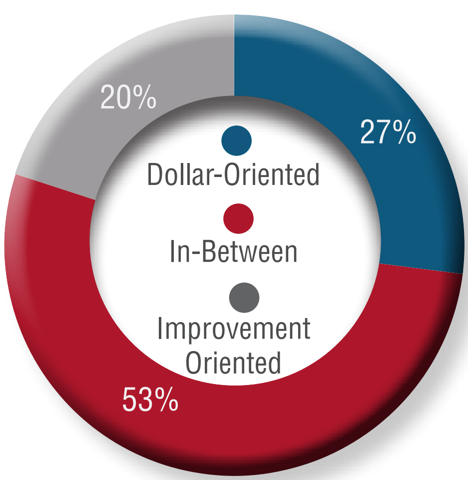
We next asked about predictions on the direction of chargebacks over the next 5 years, and vendors were a lot more pessimistic than retailers. 52% of vendors believe that the level of chargebacks will grow over that period, versus just 33% of retailers that see things that way.

Meanwhile, a solid 44% of retailers actually believe the level of chargebacks will decline over those 5 years, versus just 13% of vendors. Here, we clearly have two very different perspectives. *SCDigest* believes it is probably something like this: retailers believe a combination process improvement and the pain of the chargebacks will eventually lead vendors to reduce their compliance violations. Vendors, on the other hand, believe retailers will get more aggressive in this area, and find new ways to trigger deductions.

What Will Happen Over the Next 5 Yards with Regards to Chargebacks?



Retail Assessment of Their Compliance Program Focus



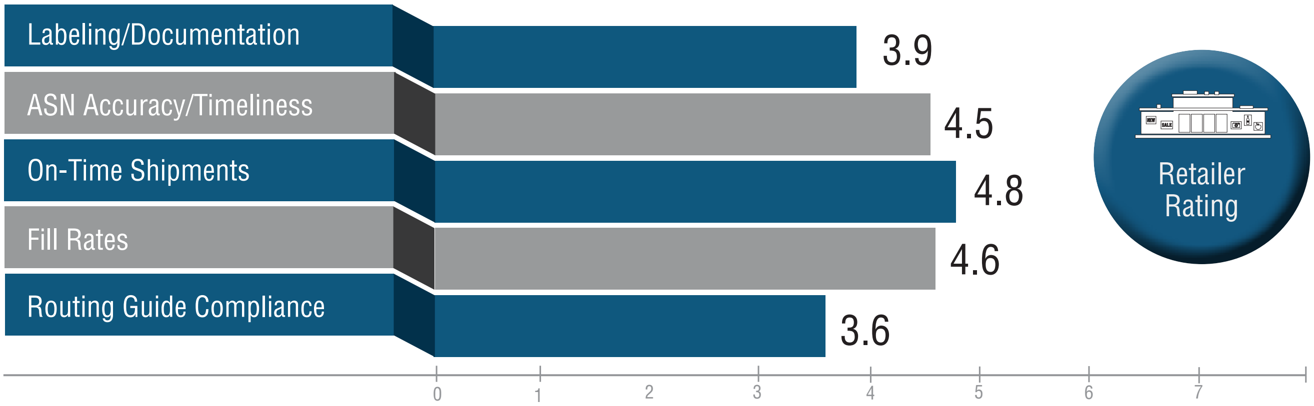
Are retail compliance programs really geared to improving supply chain performance, or are they primarily dollar focused, as many vendors perceive? We asked that question to retailers to rate their programs on another 1 to 7 score, with 1 being very dollar-oriented, and 7 being very supply chain improvement oriented.

The majority of retailers scored their programs in the middle (3, 4 or 5), indicating both a dollar and supply chain focus. More than one quarter of respondents (27%) said their programs were mostly dollar oriented, and 20% mostly supply chain improvement focused. Remember, 21% of respondents said they did not use chargebacks at all, so we assume those are most likely the same group that indicated a supply chain focus.

"Are retail compliance programs geared to improving supply chain performance? Or primarily dollar focused as many vendors perceive? The majority of retailers scored their [compliance program] in the mid-range, indicating both a dollar and supply chain focus."

What areas of compliance cause the most issues for retailers? We asked retailers to rate five of the most common vendor related performance issues, on our usual 1 to 7 scale, with 1 the least problematic and 7 the most.

Retailer Rating of Most Challenging Areas of Vendor Performance

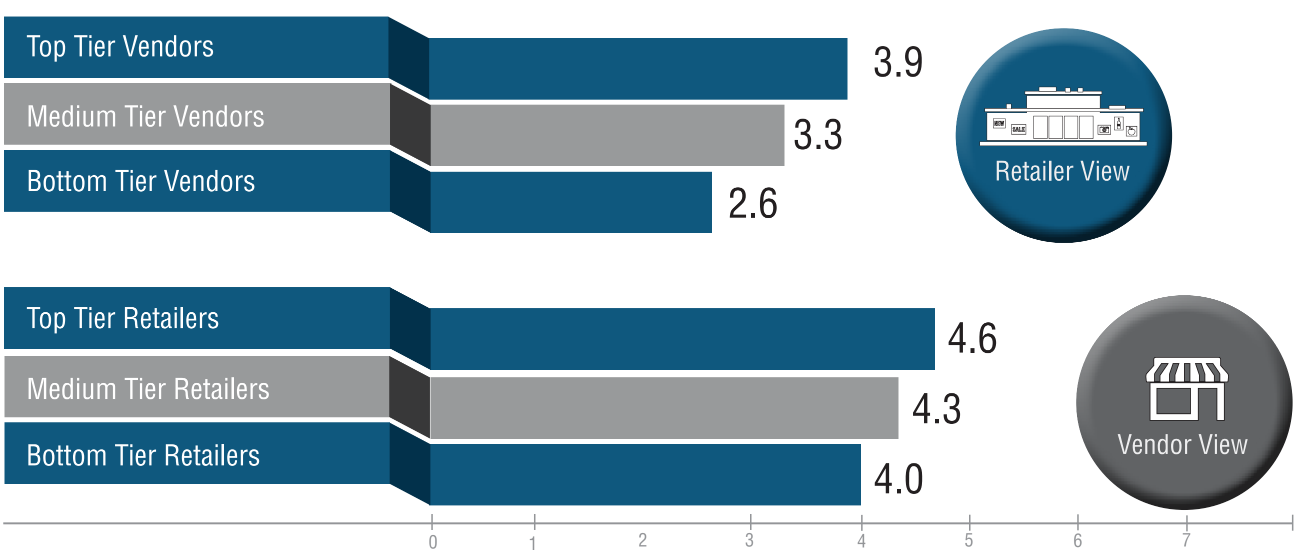


As can be seen, all five areas scored over the mid-point of 3.5, led by on-time shipments (4.8 average score) and fill rates (4.6) as the most challenging, with routing guide compliance seen as having the least issues with a score of 3.6, but still just above the mid-point.

In terms of overall collaboration between retailers and manufacturers, we wanted to get a sense not only of overall perceptions, but how levels of collaboration varied by different tiers of retailers and suppliers. We again used a 1 to 7 score, with 1 being low collaboration and 7 being very high. As can be seen below, retailers simply do not believe they have strong collaboration, with only collaboration with the top tier of suppliers above the 3.5 mid-point and just barely, with an average score of 3.9. Collaboration with the middle and bottom tiers scored just 3.3 and 2.6 percent, respectively.

Vendors had a somewhat more positive view, with all three levels scoring above the mid-point, and collaboration with the largest tier of retailers coming in with a score of a solid 4.6.

Views of Level of Collaboration by Tier of Vendor-Retailer

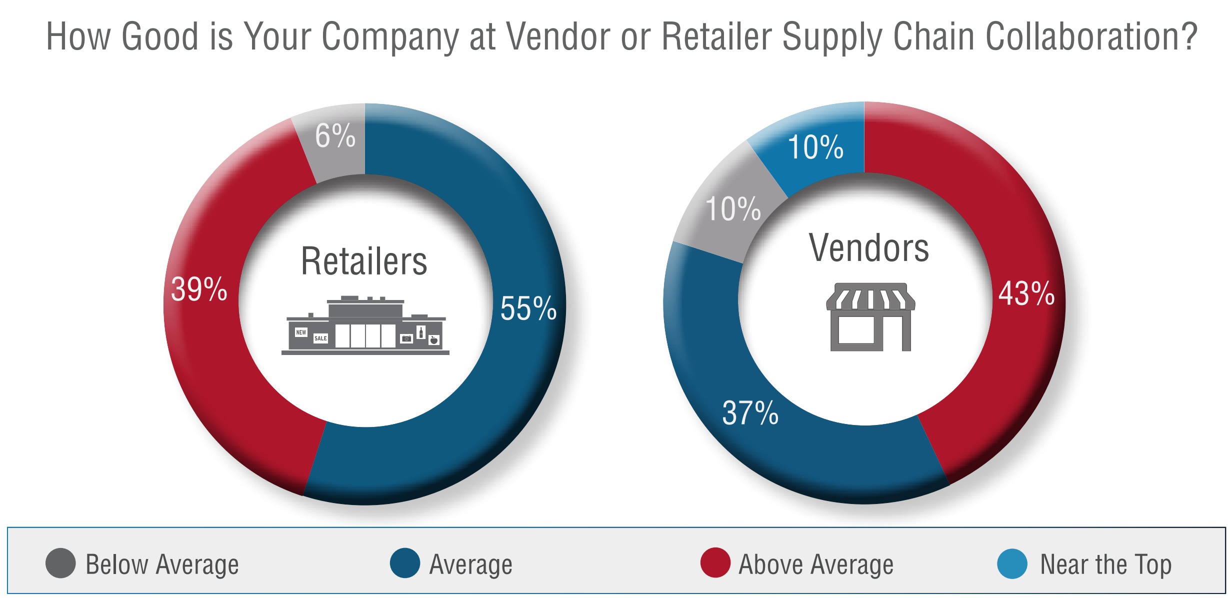


A couple of quick points: we wished we would have asked a couple of more questions, because it is not clear whether the relatively low scores retailers provided relative to collaboration is a reflection of their own lack of collaborative skills and processes, or some kind of reflection of what they see as a lack of vendor interest/support.

Second, in other surveys *SCDigest* has seen a pattern in which vendors are more bullish on the potential for collaboration than are retailers, which tend to have something more of a just "get me the goods we ordered on time" attitude. And this is no doubt in part because there is much more value to vendors in advanced order planning because of the potential for manufacturing scheduling optimization than there is to retailers. In turn, some retailers have complained that when they have done that sort of collaboration with vendors, they aren't getting anything back in terms of lower costs for their efforts or some other benefit.

We next asked each group to rate their own supply chain collaboration skills as companies.

As can be seen below, the majority of retailers place their collaborative skills as just average (55%). Thirty-nine percent considered themselves above average, and interestingly, no retailer placed itself "near the top" of collaboration capabilities.



Vendors again scored themselves as possessing higher collaboration skills than do retailers. Here, a combined 53% scored themselves as either above average or near the top, with just 37% scoring themselves as average collaborators.

That naturally enough leads to the question of what the barriers are to improved collaboration between retailers and manufacturers.

We asked retailers, vendors and the "other" category of respondents to rate a selection of potential barriers using our usual 1 to 7 score, with 1 a very low barrier and 7 a very high one.

As can be seen in the chart below, there are definitely some differences of opinion across the three groups.

What Retailers, Vendors and Other Sees as Top Barriers to Collaboration

	Retailer	Vendor	Other
Level of Trust	3.7	3.9	4.5
General Level of Interest in Collaboration	3.4	4.3	3.7
Difficulty Defining/Agreeing on How to Share Gains	4.1	4.2	4.8
Quality/Availability of Data	3.1	4.3	4.1
Clear Return on Investment	3.0	4.2	4.2
Tools to Enable Collaboration	3.2	4.5	3.8
Executive Support	3.0	4.1	4.2
Our Knowledge/Skill in How to Collaborate Successfully	2.4	3.7	4.1
Trading Partner Knowledge/Skill in Successful Collaboration	3.8	4.9	4.3

We will first note that neither retailers nor vendors think their own collaborative capabilities are a big issue, with average scores of 2.4 and 3.7 from retailers and vendors respectively. Compare that to the much higher barrier scores of 3.8 and 4.9 when retailers and manufacturers rated the other side as a barrier.

"It's not us, it's the other guy," the message seems to be.

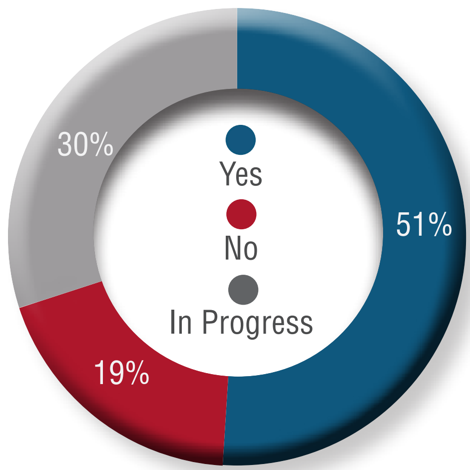
In fact, the lack of trading partner skills in collaboration was the top ranked barrier among vendors, while the top ranked retail barrier concerned challenges in how to share the gains from any collaboration. That was also the top ranked barrier from the opinions of the Other group of respondents.

In general, retailers rated almost every barrier a full percentage point or more lower than vendors, for reasons that aren't clear, other than perhaps a somewhat more simplistic view of what collaboration means versus the vendor perspective.

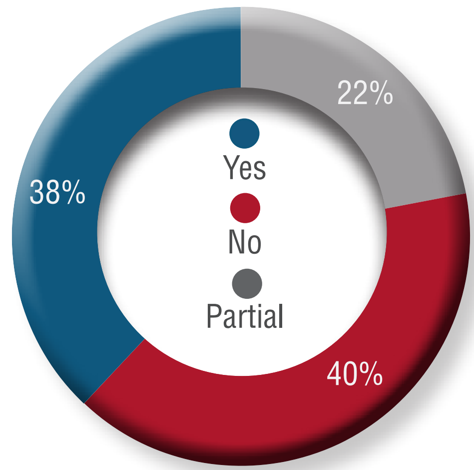
"...the lack of trading partner skills in collaboration was the top ranked barrier among vendors, while the top ranked retail barrier concerned challenges in how to share the gains from any collaboration."

How else are retailers using technology in support of trading partner integration and collaboration?

Do Retailers Have Formal Vendor Scorecard Program?



Do Retailers Have On-Line Portal for Vendor Performance?

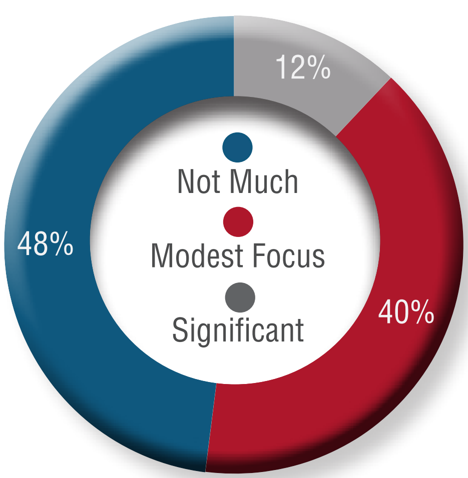


As seen in the chart above on the left, a full 81% of retailers either have a formal vendor scorecard program or are in the process of building one. Just 19% - mostly smaller retailers – do not have such a program or one in progress.

The support was somewhat less but still strong for on-line access for vendors to review their supply chain performance (see the chart above on right). Here, 38% of retailers said they offered this tool, with 22% saying "partial," we assume meaning something like "in progress."

This on-line capability to us seems almost like a best practice, and something we would hope a growing number of retailers can put in place. The technology to support that practice from providers such as Compliance Networks is readily available.

How Do Vendors See Level of Focus on Supply Chain Opportunities in Retailer Meetings?



Switching gears a bit, we also asked vendors to characterize their supply chain meetings with their retail counterparts. As shown in the chart on the left, only 12% of vendors say there is usually a significant focus in such meetings on the opportunity for supply chain improvement opportunities, versus just reviewing the vendor's own performance.

Forty percent said there was usually a modest focus on such improvement opportunities, versus the plurality of 48% who said there was little or no such focus beyond their own performance numbers.

"All told, this was a very interesting and insightful look at how retailers and vendors view their relationships, across a number of different areas, in a type of survey we don't believe has ever been conducted before."

Lastly, the RVCF organization told *SCDigest* there was some evidence that vendors lost support staff for keeping up with retailer requirements and relationships during the financial crisis, and that often these resources never came back.

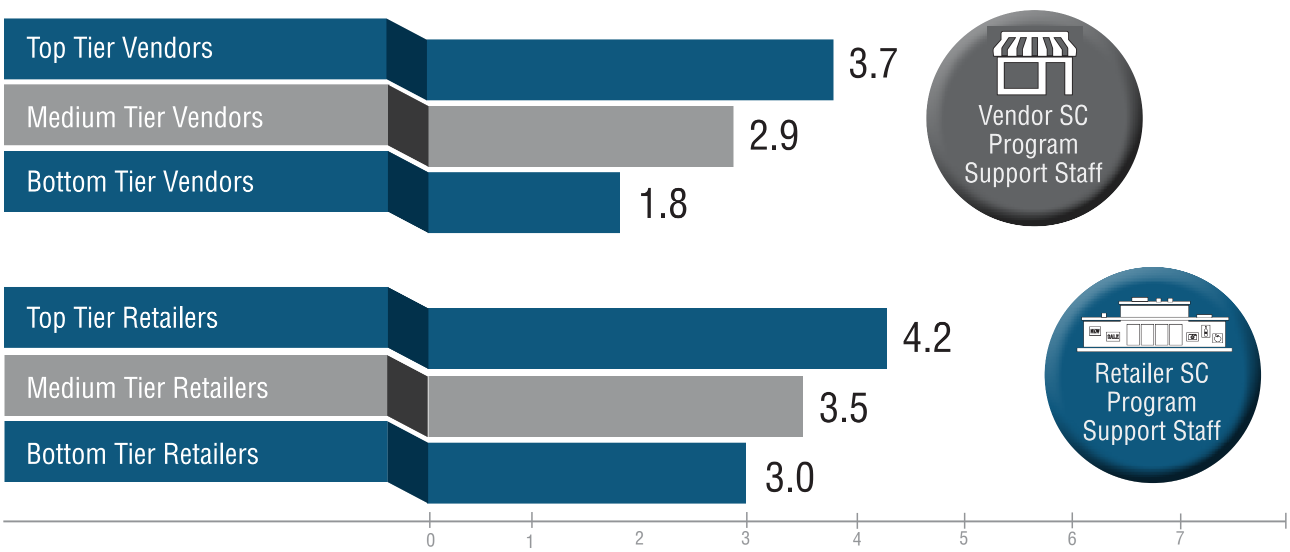
SCDigest wanted to see if this was true, and to also take a similar look at retailer support for vendors.

As seen in the chart below, on our usual 1 to 7 scale, retailers do not believe vendors have enough support for their supply chain-related requirements and relationships. Only at the top group did the retailers rate a tier of suppliers above the mid-point, and then just barely, with a score of 3.7. Retailers rated the mid-tier at just 2.9, and a very low 1.8 for third tier vendors.

The scores for vendors rating retailers were somewhat better, with top tier retailers scoring a reasonably strong 4.2, and mid-tier retailers receiving the mid-point score of 3.5.

This is an issue we believe deserves more attention.

Level of Staff Support for Meeting Each Side's Supply Chain Program Needs



All told, this was a very interesting and insightful look at how retailers and vendors view their relationships, across a number of different areas, in a type of survey we don't believe has even been conducted before.

Thoughts on the Data

Our goal in this benchmark study was not only to take a current snapshot of the state of retailer-vendor supply chain relationships in 2015, but to create a baseline of data that can be used for comparison purposes versus similar studies in years to come. We believe a biannual effort will likely be the right cycle.

The good news is that overall satisfaction with relationships is pretty strong on both sides, with scores of about 4.8 on 1-7 scale from both retailers and vendors. However, that was probably the high mark of the research, with scores in most other areas more disappointing.

As *SCDigest* has seen in other studies, vendors seem to value collaboration more and believe they are better at it than retailers. More research is needed to dig into this issue a bit more, starting with how each side views what collaboration is all about.

We believe vendors in general have a more substantive view, perhaps because they actually benefit more in their supply chains from such collaboration than retailers usually do.

Retailer chargebacks remain a hot button issue, and it seems to us the dynamics have probably little changed over the past decade. Interestingly, vendors in general are far more pessimistic than retailers in terms of the future of chargebacks, with 52% of vendors believing the level of chargebacks will increase over the next 5 years, while 44% of retailers think chargeback levels will decrease over that period, with just 33% of them believing chargebacks will continue to increase.

All told, we rate the current state of retailer-vendor relations as a grade of B-. This is a subjective view, based on continued disconnects around those chargebacks, retailers perceiving relatively low levels of collaboration across all three tiers of vendors, many perceived strong barriers to more collaboration, a lack of focus on supply chain improvement opportunities in retail-vendor meetings, and a perceived lack of staff/resources for support of the supply chain relationships.

With this data now as a baseline, we can adjust that grade up or down based on data from the next such benchmark study in a couple of years.

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