

# THE STATE OF THE RETAIL SUPPLY CHAIN

## Essential Findings of the Third Annual Report

Developed By



Research Team

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## 2012 State of the Retail Supply Chain

RILA and Auburn University's annual study on the State of the Retail Supply Chain brings together the industry's leading retailers from North America to examine the year's current trends, best practices and the foremost issues impacting the strategy and planning of retail supply chains now and in the near future.

Through senior executive interviews and an online survey, insights were captured from Supply Chain Management (SCM) executives with decades of experience in the field. Findings from the study reveal stronger SCM capacities post-recession as retailers adjust to the new environment. In contrast to last year's priorities, the focus of SCM executives has shifted from surviving the recession to fast-tracking recovery in order to face what is on the horizon for the industry.

The theme of this year's results can be summarized as cautiously optimistic. Highlights of the survey revealed that even though the recession is moving into the rear-view mirror, retailers still face some uncertainty on new issues. While SCM executives utilized cost-cutting strategies last year, the focus for the future is to balance costs while prioritizing growth and customer service. New issues such as the increasing importance of multichannel operations, the expansion of global sourcing and demand shifts from store to online platforms have emerged as top-of-mind objectives for the coming year, as well as concerns over the impact of new transportation legislation, new motor carrier safety regulations, talent retention issues and turning sustainable practices into further margin enhancement.

RILA would like to thank Auburn University for their collaboration and leadership on this study. RILA would also like to thank Accenture for their support and their continued commitment to helping retailers achieve excellence in supply chain operations. Last, we would like to thank the many retailers who participated in the study. We look forward to continuing our collaboration with retail's supply chain executives as they tackle challenges and take advantage of opportunities in the year ahead.

Best wishes for a great 2012 filled with growth and prosperity,

Casey Chroust  
Executive Vice President, Retail Operations  
Retail Industry Leaders Association (RILA)

# About the Study

## Overview of the Third Annual State of the Retail Supply Chain Report

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*“The subtext of the supply chain industry should be: ‘If it’s not one thing, it’s another.’”*

2011 was quite challenging for retailers. While U.S. retail sales were up 7.7 percent from the previous year, the growth has been inconsistent across time and retail categories.<sup>1</sup> Consumer confidence and fuel costs have fluctuated, offshore wages have increased, and the status of the payroll tax “holiday” is uncertain.

Amid this continued uncertainty, retail supply chain leaders must develop nimble strategies and capabilities. They must maintain control but be prepared for growth, balance store and consumer direct fulfillment requirements, and manage an increasingly complex inbound supply chain.

This “one thing or another” subtext makes life interesting, according to one retail supply chain leader. It also provides the setting for our State of the Retail Supply Chain (SRSC) Report.

### **Recap: Second Annual Report**

Supply chain performance was one of the few retailing bright spots during the year. Despite battling with inconsistent sales, an anemic economic recovery, and vacillating transportation rates, supply chain executives provided calm, controlled leadership to their companies. Through it all, goods continue to flow to the store shelf in an efficient, effective manner.

Despite the external uncertainties, the strategic focus of supply chain executives shifted from all-out cost cutting to a more balanced perspective. They realized that a pure inventory rationalization focus would leave their organizations susceptible to lost sales as the economy recovered. Hence, they moved to meet customer expectations of continuous product availability while maintaining strong control over inventory levels and waste.

With the support of top management, supply chain executives pursued numerous initiatives to meet these goals. Investments were made to refine supply chain capabilities and enhance internal alignment. Closer ties were forged with merchandising and store leadership to improve cross-chain agility, asset utilization, and visibility. And, innovative retailers expanded the sphere of supply chain activity with multi-channel and manufacturing capabilities.

### **Research Objectives: Third Annual Report**

The purpose of the SRSC Report is to continue our investigation of supply chain practices that positively impact retail organization success. Our third annual study addresses five timely topics:

*Supply Chain Strategy:* How are supply chain investment plans and areas of strategic emphasis evolving?

*Multi-Channel Fulfillment:* How are supply chain executives aligning fulfillment to serve rapidly growing consumer direct channels?

*Strategic Sourcing:* How are supply chain leaders working with suppliers to manage the growing complexity of a global supply base?

*Information Technology:* Which supply chain technologies are being used by retailers to improve performance?

*Impending Issues:* What challenges, risks, and strategic opportunities hover on the horizon for SCM executives?

In the pages ahead, we present an in-depth analysis of each question. The results can be used by retailers and their supply chain partners to benchmark their strategies and practices against those of major U.S. retailers.

*“Our overall objective is to provide the appropriate level of product availability at optimal inventory and cost levels. That won’t change over time.”*

## Study Methodology

The current research stems from the emerging supply chain issues identified in the second annual report. To gain meaningful insights from the major players in retailing, we pursued participation from organizations with: (1) annual revenues exceeding \$1 billion; (2) multi-channel capabilities; and, (3) broad geographic activity.

Information for this report was gathered via senior executive interviews and an online survey. A total of 199 retail supply chain executives took part in our research this year. Table 1 provides demographic highlights of the participant pool.

Table 1: Demographic Characteristics of Participants

Characteristics	Summary
Company revenues exceed \$1 billion	67.3%
Company has multi-channel operations	68.3%
Director-level or above	72.9%
Retail experience	17.1 years

Given the aforementioned preferred participant profile, the results sections of this report focus on retailers with 2011 sales exceeding \$1 billion. Subsequent publications will analyze the supply chains practices of smaller retailers.

## Senior Executive Interviews

We began the current initiative with a series of 35 expert interviews. Most of the participants are based in the United States, with 20 percent from Canada, Europe, and South Africa. The semi-structured nature of the interviews provided an excellent opportunity to explore a variety of topics with these supply chain executives. Their input helped us understand the capabilities that drive exceptional retail supply chain performance.

## Online Survey

We developed an Internet-based survey to analyze the research objectives and issues uncovered during the interviews. A survey link was distributed by RILA, direct email, and a market research firm. These methods netted 164 survey responses from supply chain executives, 105 of whom work for high revenue retailers.

Our research team compiled the data, reviewed interview transcripts, and analyzed the results. This report reveals our key findings via discussion, graphics, and expert quotes.

## Study Participants

We want to thank each supply chain executive who participated in our research. Their collective contribution of time and insights make this report possible each year. As the sample list below indicates, the participants cover a wide range of retail formats and geographic operations:

Army Air Force Exchange	Limited Brands
Academy Sports	Lowe’s
American Eagle Outfitters	Marks and Spencer
Ascena Retail Group	Meijer
AutoZone	Michaels Stores
Best Buy	Office Depot
Big Lots	OfficeMax
Canadian Tire	PETCO
Casey’s General Stores	Petsmart
CVS Caremark	Primark
Dick’s Sporting Goods	QVC
Dillard’s	Sam’s Club
Dollar General	Sears Holding Co.
Dollar Tree	The Sports Authority
Famous Footwear	Staples
Giant Eagle	Target
Giant Tiger Stores	TJX
H.E. Butt Grocers	Walgreens
The Home Depot	Walmart
Kohl’s	Winn-Dixie

# Current Issues and Strategies

## Retail Supply Chain Executives Prepare for Better Days Ahead

*“The art of the supply chain is managing uncertainty and working to mitigate risk.”*

After racing to reduce costs and eliminate waste in their supply chains, many of the best retail organizations exited the recession with stronger supply chain capabilities. They are well-prepared for the next market event, whatever that may turn out to be. Retailers have positioned themselves to take advantage of anticipated sales growth, but at the same time attempt to protect against expanding too fast in an uncertain environment.

### The Big Issues of 2011

The supply chain environment is constantly evolving which creates new challenges each year for retailers. The critical issues identified by supply chain executives during the interview phase are listed in Table 2.

Table 2: Areas of Concern

Area of Concern	Rank
Impact of transportation regulation	1
Transportation capacity	2
Talent retention	3
Making sustainable practices profitable	4

The first three issues listed are each tied to the broad perception that the economy would grow, perhaps strongly, in 2011. The new motor carrier safety regulations were the most frequently referenced topic of concern in this year’s interviews. The prime issue is the potentially negative impact the regulations may have on carrier capacity. The capacity issue is multi-faceted. Executives hold a belief that many motor carriers cut too deeply during the recession and may not be ready to handle the needed volumes should sales grow more rapidly than planned.

The improving economy presents a potential supply chain personnel problem for retailers. Several executives expressed concern that the improving economy may make it more difficult for them to retain top employees as competitors seek to fill positions created by sales growth.

Sustainability has been a topic of interest to retailers for the past decade and has become an expected part of supply chain operations. Our study participants require sustainability initiatives to be profitable, or at least break-even, like any other capital project.

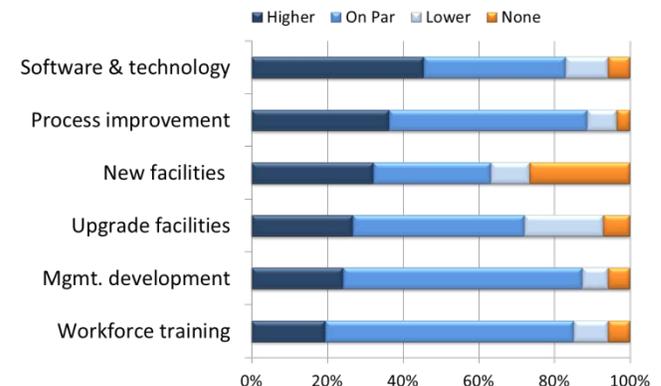
*“Sustainability is an area of ongoing focus. It’s slow in coming, but there will be a point where it financially starts making a lot more sense.”*

### Looking Toward 2012

Retailers have a positive outlook for 2012, with 64 percent of our participants projecting higher revenues than in 2011 versus only two percent anticipating a decline.

Increased investment plans reflect this level of confidence. Priorities are technology and process improvement as retailers seek to integrate their fulfillment channels and the supply chain. 2012 spending plans are highlighted in Figure 1.

Figure 1: 2012 SCM Investment Plans



*“Becoming the channel of choice for suppliers differentiates us and gives us a strategic advantage our competitors can’t match.”*

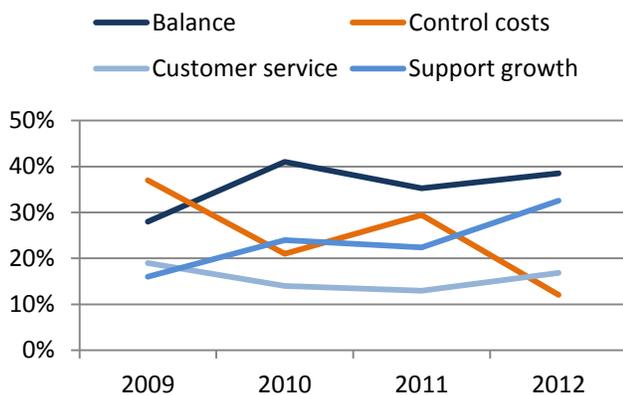
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Supply chain strategies continue to evolve and adapt to a rapidly changing set of circumstances. In addition to being nimble, a supply chain strategy must align with and support company-wide strategies. We asked supply chain executives about their strategies and discovered some interesting changes that affect both the immediate and short-term timeframes.

### Shifting Strategic Focus

Each year, we ask the survey participants to describe their supply chain strategy and strategic emphasis for the upcoming year. Figure 2 summarizes the strategies throughout the life of the SRSC Report.

Figure 2: Strategic SCM Focus



Looking back to the depths of the recession, cost control was understandably the top strategy of supply chain executives in our initial report. It dipped the following year, only to rise again in the third annual study. Looking forward to 2012, cost has given way to other strategic priorities, among the participants. Despite this shift, we are certain that costs never fall off the radar screens of supply chain executives.

*“It’s all about speed to market so there’s a great focus on how we eliminate dwell time.”*

The balanced strategy – an equal emphasis on cost and customer service – remained the top supply chain issue for the second straight year. It is again viewed as the top strategy in 2012. Interestingly, the growth strategy is rising in importance, moving from the least considered strategy in 2009 to the second highest priority for the upcoming year.

*“All strategy is driven from the customer if it’s done right.”*

Efficient cost control and effective customer service are the two primary performance outcomes of a well-run supply chain. It is somewhat surprising then, that the customer service strategy continues to be found at or near the bottom of the rankings each year. The popularity of the balanced strategy – a combination of cost and service – may have something to do with this result.

Supply chain strategy has clearly been tied to the state of the economy in recent years, and cost control will surely return with the next downturn. We will continue to monitor the supply chain focus of retailers to understand the trends and emergence of new strategies.

### Key Takeaways

Supply chain strategy is integral to retail success. Top retailers are spending millions of dollars annually to upgrade and integrate their supply chain capabilities. An effective strategy is one that is grounded in the overall company strategy yet remains flexible enough to adjust to unanticipated changes in customer desires, competitor efforts, and the economy. A balance between cost control and excellent customer service is the preferred strategy of today’s best retail organizations.

# Best-In-Class Capabilities

## Pursuing Supply Chain Excellence

A recurring theme of our research is to uncover supply chain capabilities that help differentiate leading retailers from their competition. Though no single retailer possesses every best-in-class attribute that the research has identified, leaders are pursuing excellence on multiple fronts.

During the second annual study, we identified three practices that are building blocks for superior SCM. They include:

**Supply Chain Agility** Supply chain leaders realize that agility is a key competency to successfully address changing marketplace conditions. Our research revealed that agility is driven by simplicity, visibility, and velocity. These are created by logical processes, a strong information systems backbone, and a speed to market focus.

**Shelf-Driven Supply Chains** Extending supply chain control and influence beyond the store dock door to the retail shelf is a capability that sets best-in-class retailers apart. They integrate shelf space planning with supply chain planning, link packaging and picking practices with shelf capacity, and work with store personnel to improve the dock-to-shelf flow of product.

**Internal Manufacturing** Leading retailers enhance private label performance by owning and operating the production echelon of the supply chain. It gives the retailer greater control over product availability while eliminating supplier markups. This vertical integration strategy is prevalent in the grocery industry, though it is also used for apparel.

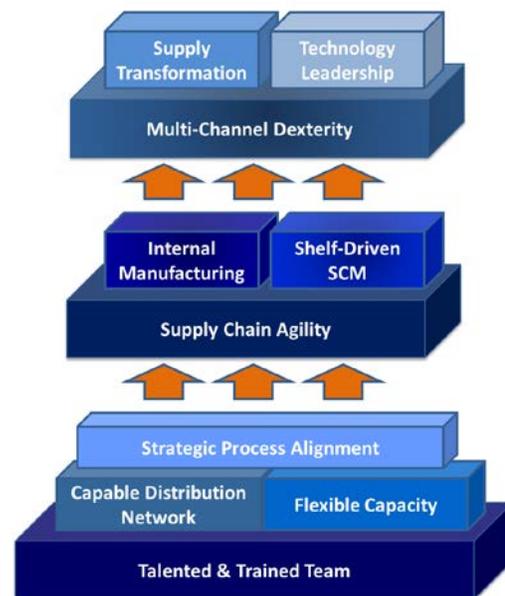
These three strategies align well with the four best-in-class practices revealed in the inaugural SRSC Report. The capabilities include: developing a well-trained team, building a cost efficient network, creating scalable capacity, and strategically aligning supply chain processes with organizational strategies.

As time advances, best-in-class capabilities are often widely adopted and become standard practices across the retail supply chain. No longer do they provide a distinct benefit. Also, the impact of a leading practice may wane as stakeholder needs change. Supply chain executives must vigilantly seek out new paths to competitive advantage.

*“Having responsive capabilities inside your supply chain is critical because you can’t really tell what might be around the corner.”*

Leading retailers are well attuned to the need for responsiveness. They are pursuing a variety of strategies across sourcing and order fulfillment processes that respond to shifting supply chain requirements. Figure 3 reveals these best-in-class capabilities.

Figure 3: Best-in-Class Capabilities



Given their potential impact on supply chain responsiveness, the most recent additions to the best-in-class model will be discussed in detail.

# Capability 1: Multi-channel Dexterity

Providing Anytime, Anywhere Demand Fulfillment

*“Customers must be able to interact with us when, where, and how they want whether it be at home, mobile, in the store, or via phone. We have to support these different channels.”*

## The Key Issues

The latest holiday season data provides ample proof that few retailers can afford to ignore the growing importance of multi-channel retailing. Electronic commerce sales grew by more than 15 percent to \$35.3 billion, with mobile commerce playing a growing role. In comparison, total sales were 4.1 percent higher than the previous year.<sup>2</sup>

The opportunity will only grow larger over the next few years. Forrester Research predicts that U.S. e-commerce sales will grow 10 percent annually. eMarketer forecasts that m-commerce will grow nearly tenfold in the next few years. Their respective projections for 2015 are \$279 billion and \$31 billion.<sup>3</sup>

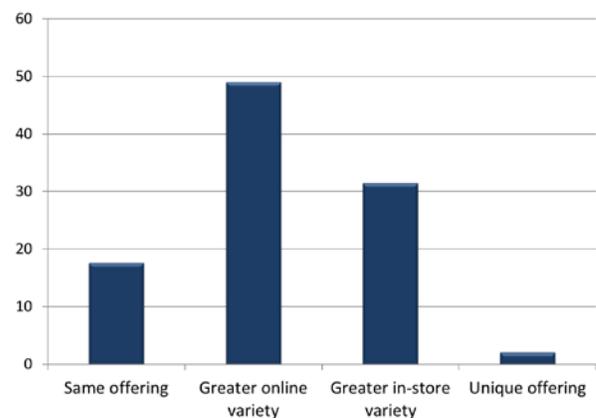
The opportunity and challenge of this retailing phenomenon are not lost on our respondents. Over 85% of our participants indicated that direct to consumer fulfillment will command a greater level of their attention in the future. Their imperative is to create a seamless customer experience regardless of the fulfillment channel order size, origin, or delivery requirement.

## The Response

Our study participants are well acquainted with the demands of multi-channel fulfillment. Nearly 70 percent work for multi-channel retailers. The typical retailer in this group derives nine percent of sales from consumer direct channels. That will grow to 15 percent in the next few years. An additional 16 percent of the participants work for traditional retailers that are adding (or plan to add) consumer direct channels in the near future.

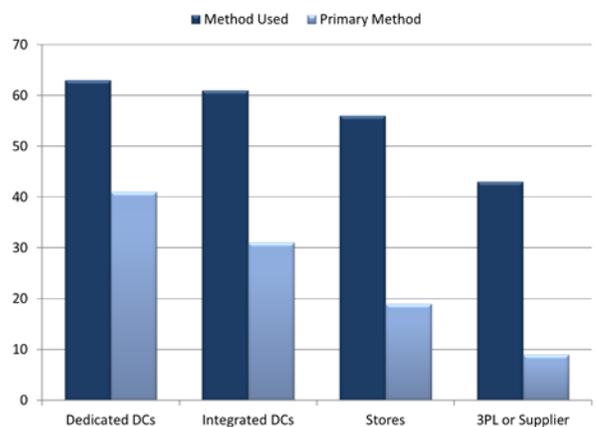
Serving multiple channels brings about a host of fulfillment challenges. The obvious issues include variation in shipment size, order filling processes, and delivery methods. Compounding the problem is the inconsistent SKU mix of multi-channel retailers. As Figure 4 indicates, less than 18 percent of the companies in our research offer the same SKUs across channels.

Figure 4: SKU Mix



The participants fulfill consumer direct orders through the options revealed in Figure 5. A typical retailer uses two or three of these methods. The dedicated facility model is popular among retailers as the primary fulfillment method, followed by integrated fulfillment.

Figure 5: Consumer Direct Fulfillment Methods



*“The holy grail is figuring out how to use one inventory pool to serve both stores and direct customers.”*

### Fulfillment Selection Strategy

Over the years, much has been written about how consumer direct orders are filled. Far less effort has been devoted to why a particular method is chosen or should be chosen by a retailer. This may not have been a critical issue early on because the level of direct fulfillment activity was relatively small. As volume grows and direct channels expand, “why” becomes a much more strategic issue for retailers.

Figure 6 presents the primary options and issues that retail supply chain leaders must evaluate when developing a fulfillment selection strategy.

### Integrated Fulfillment

The integrated method leverages inventories across the channels and utilizes existing facilities. Consumer direct and store orders are processed concurrently with the same staff. Only during the shipping activity are the orders segmented.

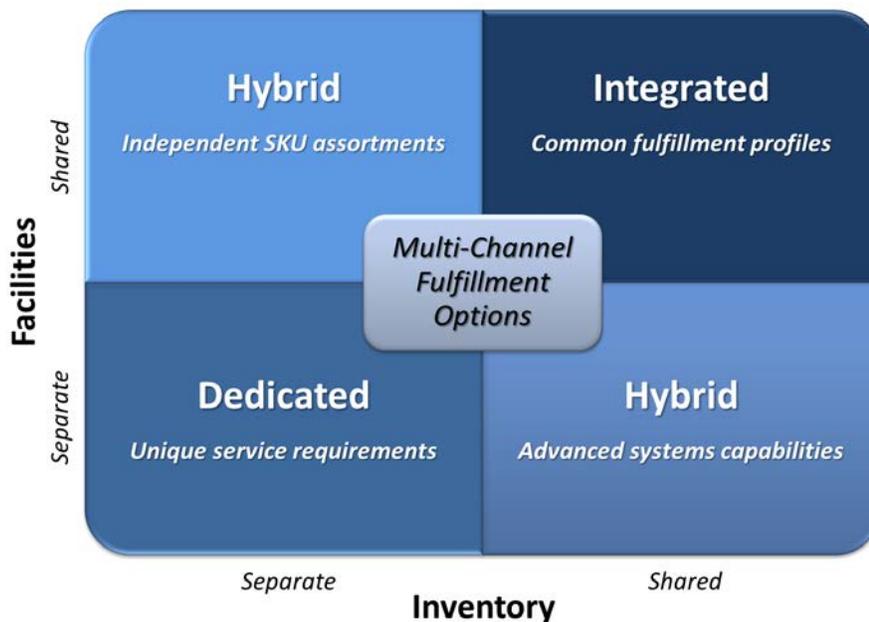
A common fulfillment profile and unit of order characteristics are necessary for integration. Retailers that already pick store orders as individual units can readily add consumer orders to existing picking modules and processes.

Another requirement is velocity. Given the speed with which consumer direct orders need to be filled, the retailer must have enough capacity to interleave consumer direct orders with the current store processing schedule.

Inventory commonality is also important. To gain the maximum benefit from the integrated strategy, the SKUs offered in-store and online must be reasonably consistent.

Integration produces many benefits. Investment in new facilities and major systems upgrades are avoided. Inventory turnover will improve and safety stock can be reduced. Visibility and control will be enhanced by having all activities under one roof. Process realignment and layout modification are the primary requirements.

Figure 6: Main Consumer Direct Fulfillment Methods



*“We use freestanding e-commerce fulfillment centers but carved-out space in our import warehouses to catch large items. Those get shipped directly to customers.”*

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### Dedicated Fulfillment

The dedicated method establishes independent facilities to segregate fulfillment by selling channel. Operations are tailored to specific order profiles, frequencies, and value-added service requirements of each channel or customer type. These unique channel requirements largely dictate the use of dedicated fulfillment.

Inventory issues, such as differing SKU mixes or financial reporting processes, drive the use of the dedicated method. Physically separating the inventory greatly reduces the risk of order picking errors, confusion, and allocation problems.

Scale is essential. High volume allows the facility to achieve economies and competitive fulfillment cost per unit for the channel. If segmentation is needed but volume is low, a viable alternative is third party fulfillment of consumer direct orders.

*“When you have the scale that we do on both sides, a lack of a common assortment and differences in requirements, there isn’t an incentive to integrate. That’s why we segment.”*

The dedicated method avoids reliance on a “one size fits all” fulfillment process that compromises service to all channels. Systems integration issues are limited as the channels operate as separate entities. Finally, our study participants indicate that method produces an acceptable ROI via their operating cost advantages.

### Hybrid Methods

Many organizations combine elements of the integrated and dedicated models. These hybrid networks sometimes evolve without a master plan. However, optimal results are achieved when a specific strategy drives product and customer assignment to a fulfillment facility in the network.

One option is to have separate inventories for retail replenishment and consumer direct orders within a single facility. The orders are processed independently because store and consumer direct SKUs are unique, fulfillment processes and schedules are incompatible, or shipping methods differ. Though inventory benefits and processing productivity are sacrificed, this hybrid option generates efficiencies through the use of existing facility capacity and shared labor.

*“How do we leverage our core business to enable success in other channels? We need to become more nimble and capable of handling business in multiple forms.”*

Another hybrid option is to serve consumer direct orders from a common inventory pool across separate facilities. Based on inventory availability and fulfillment cost, retailers steer orders to designated stores for employee picking and customer pickup or local delivery. Alternatively, the order can be sent to suppliers for drop shipment or to a DC for fulfillment. This method leverages system-wide inventory, fulfillment capacity, and the delivery network. Advanced technologies like distributed order management enable the implementation of this strategy.

### The Takeaways

In this “anytime, anywhere, any way I choose” environment, supply chain leaders must establish the appropriate mix of fulfillment capabilities. Their networks and processes must be properly aligned with each channel’s order characteristics, inventory profiles, and service requirements.

Leading edge retailers are strategically refining their supply chains to accommodate customer demands for rapid, accurate, and (sometimes) free order fulfillment. They know that a high profile fulfillment failure is not an option.

*“Our VP has responsibility for the entire global supply chain capability. This executive ultimately controls e-commerce and store fulfillment.”*

### Strategic Fulfillment Integration

Strategic process alignment was identified as a best-in-class capability during the inaugural SRSC Report. Important issues included: breaking down functional silos, holistically managing processes, and weaving supply chain management into the organizational fabric.

These integration issues must also be prioritized as consumer direct channels grow. Regardless of the fulfillment methods used, retailers should integrate the management of consumer direct and store channels. But, is this the case?

Figure 7 suggests that this is definitely not the case for the majority of our participants. Less than 40 percent assign strategic control over both store and consumer direct fulfillment to a single executive. Often, these responsibilities are split among multiple leaders. The other option is to have a single executive, other than the chief supply chain officer, in charge of consumer direct fulfillment.

*“It’s completely separate inventory, completely separate process from supply chain. In fact, it doesn’t even report to me. It’s a marketing thing.”*

Figure 7: Responsibility for Consumer Direct Fulfillment



\* This individual oversees both store and consumer direct fulfillment processes

From a supply chain viewpoint, the integration opportunity is not being fully leveraged. Figure 8 indicates that our participants rate their integration success as moderate, particularly in terms of supply chain information systems and strategy. They are more successful in terms of coordinating fulfillment processes and inventory sharing, but integration remains as a major supply chain opportunity.

Figure 8: Consumer Direct and Store Integration



This shortcoming is not lost on our participants. Only 10 percent strongly agreed with the statement: *“We have achieved a desired level of integration between our retail stores and direct to consumer fulfillment operations.”*

### The Takeaways

Retailers cannot afford to decouple store and consumer direct fulfillment activities. Having both under the auspices of a single supply chain executive simplifies decision making and generates consistent fulfillment strategies. Also, opportunities to integrate operations, share inventory, and harmonize systems increase.

Cutting edge retailers leverage their integration capabilities to deliver a seamless cross-channel experience. Meanwhile, integration will remain a vexing issue for most retailers in 2012.

# Capability 2: Sourcing Transformation

## Moving Toward a Broader View of Collaboration

*"We don't have to solve all the problems. We've got some really bright suppliers who are thinking along the same lines we are around supply chain efficiency and effectiveness."*

### The Key Issues

Aftershocks of the recession are still being felt across global supply chains as retailers and suppliers shared the pain of rapid business contraction. Initial retailer belt-tightening caused many suppliers to struggle as they brought down excess capacity. Supplier response was too strong in some cases and their efforts to eliminate production and shipping capacity produced numerous service failures for retailers.

Although damage occurred to retailer-supplier relations, the survivors from both sides are now leaner and better prepared for the next set of challenges. Many of the best retailers are relying on key suppliers even more heavily today.

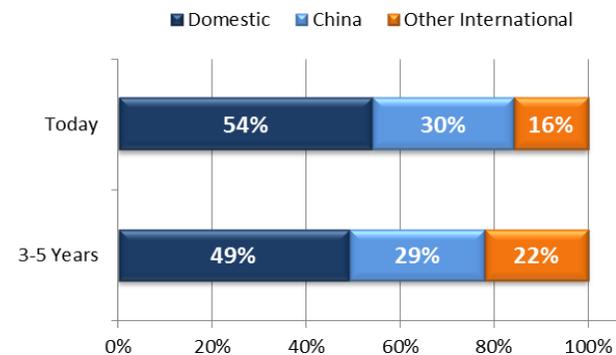
The best retail supply chains demonstrate the ability to adapt quickly to changing conditions and customer requirements. Today more than ever before, retailers count on their best suppliers to manage the growing complexity found across the supply chain. To accomplish that the concept of collaboration has evolved to recognize the value provided by capable suppliers.

### The Response

The supplier base for many retailers has become increasingly global over the past decade. Figure 9 shows that this trend is expected to continue. Although sourcing in China is expected to remain constant, our participants anticipate a 5-6% loss of domestic sourcing to countries other than China.

*"Most everyone in the world is looking at how they can do business with a smaller number of more reliable suppliers."*

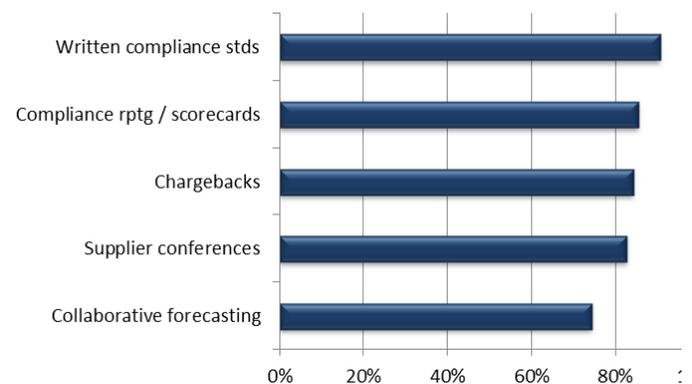
Figure 9: Geographic Dispersion of Sourcing



This trend has fueled the need to strategically consolidate suppliers in order to manage risk associated with supplier underperformance. Supply chain executives are particularly interested in addressing is to reduce the number of suppliers involved in the manufacture of private label products. These retailers have concluded that the best way to ensure product consistency is to have all units be produced at the same factory rather than spread volume out across multiple locations.

Our participants routinely evaluate suppliers to ensure service and quality needs are being met. Figure 10 reveals that retailers routinely focus on identifying and eliminating poor performing suppliers. However, supply chain executives also use proactive tools to ensure their top suppliers are well-aligned with key initiatives.

Figure 10: Supplier Alignment Methods



*“Economic contraction has enhanced collaboration. The pain has increased the willingness of suppliers to be open to innovation and consider taking more risks.”*

Retailers have limited time and personnel to dedicate to supplier relations. This fact keeps true collaboration limited to a few key suppliers. A majority of our participants indicated that they actively manage between five and fifteen strategic collaborative supplier relationships. Those on the low end of this range tend to focus on product categories that are dominated by a few large suppliers.

*“We look for suppliers that can provide thought leadership, that really come to the table with new ideas and information.”*

The collaboration coming from these strategic relationships are arguably more balanced than in the past. They are focused on efficiency and effectiveness improvement across the entire supply chain. It should be no surprise that our participants frequently described these strategic suppliers as among their best suppliers. The most mentioned characteristics of excellent suppliers are listed in Table 3.

Table 3: Characteristics of Best Suppliers

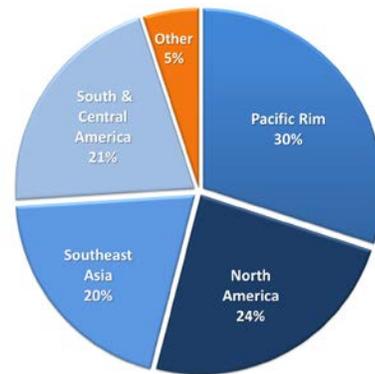
Supplier Characteristic	Rank
Reliable execution based on retailer KPIs	1
Excellent communication regarding problems and challenges	2
Willingness to change	3
Innovative: share ideas & information	4

The ability to execute consistently and exceed key performance metrics, especially fill rate and on-time delivery that leads to high retail shelf in-stock, was cited by most participants. Retailers rely on their best suppliers to drive improvement across the supply chain. This is seen in the importance of suppliers being ready to implement necessary changes to remain competitive. Innovative suppliers that develop improvement ideas are especially valued.

### The Future of Global Sourcing

Though non-domestic sourcing of product and support services will continue to grow in the next few years, China may not be the focal point for expansion. Figure 11 shows the major growth areas outlined in our survey results.

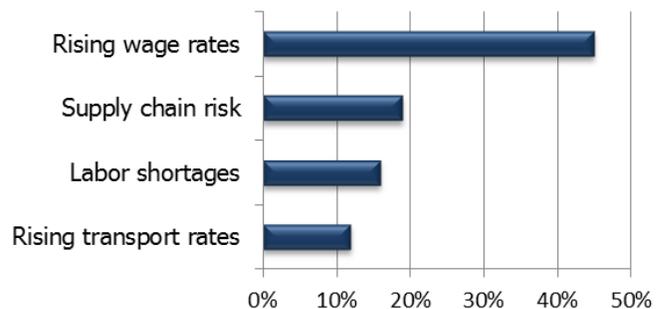
Figure 11: Global Sourcing Growth Areas



Pacific Rim and Southeast Asian countries are projected to make up half of all new sourcing over the next five years. Interestingly, North and South America are expected to see solid growth. This option allows retailers to reduce supply chain length and associated risks.

The geographic shifts are a result of suppliers' opportunistic moves to avoid problems, as shown in Figure 12. A retailer desire for nearshoring is not the main driver, according to our participants.

Figure 12: Reasons for Sourcing Location Shifts



*"We work with our supplier partners and service providers to figure out better solutions to take cost out of the system and optimize the network."*

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### Strategic Multi-supplier Council

Past perceptions of retailer-supplier collaboration were heavily slanted in favor of solving the retailer's problems. The role of the supplier was to comply and attempt to minimize the damage on their own business to the extent possible. This view has shifted in recent years to a more balanced collaborative environment that targets holistic supply chain improvement benefitting the end customer and both parties.

A problem remains in that balanced collaborative efforts involving individual suppliers may not benefit the hundreds of other suppliers and service providers in the supply chain. Creation of a supply chain council consisting of several top suppliers and service providers creates a vehicle to address broader supply chain issues.

*"We are very open to trying new ideas and working with suppliers on initiatives to take time and costs out of the supply chain."*

A select few participants use some version of this tool currently. However, one-third of those surveyed said they plan to utilize strategic supplier groups to participate in developing future strategic supply chain plans.

### The Takeaways

The goal of a multi-supplier group is to identify the most significant issues that promote optimal performance across the supply chain. Leading edge retailers use these councils to improve visibility and understanding of problems that occur early in the supply chain (e.g., activities that occur at the raw materials or component manufacturing stages). The suppliers' proximity to the problems helps them understand the root causes of the problems and how to best address them.

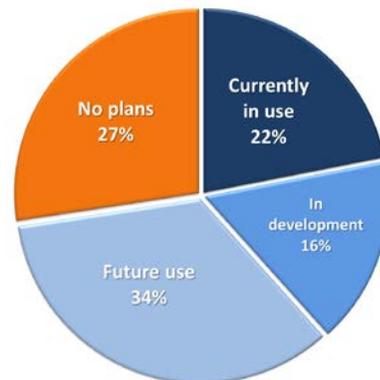
### Gainsharing

The desired outcome of supplier collaborative efforts is identifying opportunities to improve supply chain operations and efficiency. One way to ensure success is to provide a gainsharing incentive to all parties participating in the collaboration.

*"We've re-designed the network and we're able to reduce the cost to serve the customer. We're both sharing in the savings."*

Figure 13 shows that gainsharing is being used by 22% of our participants. This strategy appears to be gaining traction as 50% of our respondents are developing or planning to use the technique at some point in the future.

Figure 13: Retailers' Interest in Gainsharing



### The Takeaways

Gainsharing agreements are simple in principle but often prove difficult to implement. They require all parties to disclose proprietary information (e.g., operating costs) before and after implementation of a new solution. This has been an insurmountable obstacle for many retailers in the past. Supply chain leaders who learn to implement such agreements will find enthusiastic partners ready to help tackle the most challenging problems.

# Capability 3: Technology Leadership

## Assembling a Solutions Toolkit

*“As SKU counts continue to increase, we need to stay out in front of the technology and make sure that our supply chain systems support the initiatives of the company.”*

### The Key Issues

Without a doubt, the retail supply chain is growing more complex each year. Sourcing locations are more fluid, product assortments are in flux, and customers expect 24-hour access to inventory from their location of choice. As a result, supply chain information must be available on a moment's notice, accessible to multiple parties, and accurate.

The challenge is compounded by a variety of internal expectations. Under the pretense that information will supplant safety stock, C-level executives expect lean inventory levels without a drop in service levels. Merchants want to make last minute allocation decisions and have cross-chain visibility of their goods. And stores need rapid replenishment of fast-selling goods.

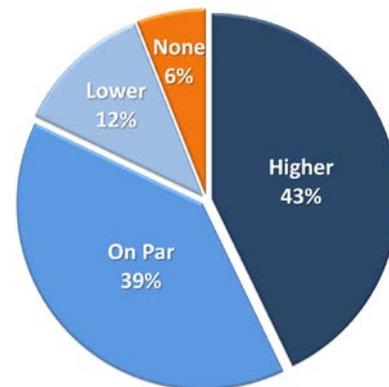
Though these demands are expanding, supply chain leaders must continue to achieve traditional goals. The need for process and labor productivity, cost-efficiency, and return on investment goals have not gone away just because stakeholder requirements are expanding. Success is achieved only when both sets of objectives are achieved.

### The Response

As supply chain complexity and integration demands grow, disparate systems and manual information management must be eliminated. Recognizing the need to align and automate processes, supply chain leaders are actively upgrading their systems. Among our participants, software and technology spending was the top supply chain investment category during 2011. Nearly 30 percent identified it as their spending priority, a rate higher than the previous year.

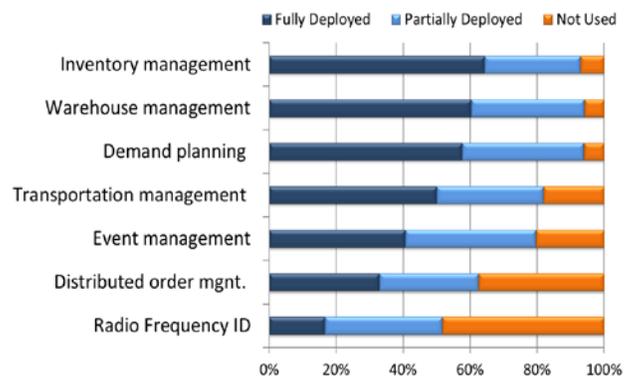
The desire to leverage innovative supply chain technologies is expected to continue over the next 12 months. As Figure 14 highlights, more than 80 percent of our survey participants plan to maintain or increase their spending levels.

Figure 14: SC Technology Spend: 2012 vs. 2011



The participants' investments have focused on the traditional supply chain tools identified in Figure 15. Some retailers have an opportunity to expand their partially deployed solutions, while technology laggards need major investment to avoid falling further behind.

Figure 15: SC Technology Deployment



In contrast, innovative retailers have deployed cutting-edge tools. These solutions promote cross-channel integration and improve control.

*“...serve the consumer from any node in our supply chain, provide visibility of where the product is in the pipeline, and really control the customer experience.”*

## Distributed Order Management

Complex challenges await supply chain leaders who must orchestrate activities across complex multi-channel networks. They need powerful coordination tools to support both store and direct fulfillment. Amongst the existing options, experts recommend distributed order management (DOM) software as a logical response to retailers’ multi-channel needs.

DOM software gives retailers the ability to capture, manage, and optimize orders regardless of origin – computer, retail store, kiosk, or mobile phone. After order capture, the DOM system identifies the fulfillment facility or channel that will best serve the customer and the retailer. This automated selection process is based on inventory availability, cost of delivery, order processing capacity, customer requirements, and related factors.

Savvy supply chain executives focus on DOM solutions with robust modeling tools and rules engines that support intelligent fulfillment decisions. Table 4 provides an evaluation of DOM capabilities by our study participants.

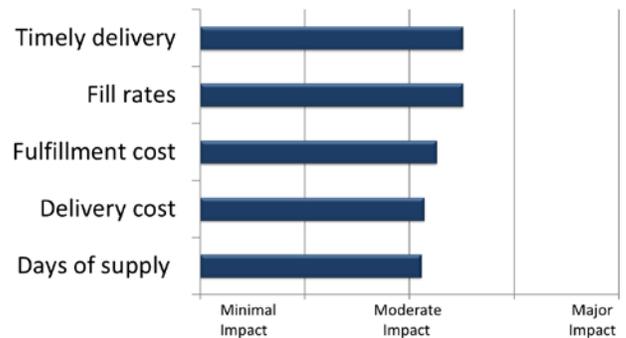
Table 4: Strength of DOM Capabilities

Capability	Rank
Provides global real-time visibility of inventory and orders	1
Enhances fulfillment network flexibility and integration	2
Supports multi-site sourcing and merge-in-transit for individual orders	3
Supports order tracking, modification, and cancellations through order cycle	4
Enables enterprise-wide optimization of order fulfillment	5

*“This multi-channel operating system really helps us tie everything together and use the information to drive the order activity.”*

DOM has a positive effect on operational efficiencies and supply chain KPIs. Figure 16 indicates that success to-date has been moderate among most DOM users in our research. Our analysis revealed that full deployment of DOM across all fulfillment processes nets the greatest cost reductions.

Figure 16: DOM-Driven Impact on Performance



Market benefits are also derived via DOM. Customers can shop locally or access available-to-promise inventory from stores, fulfillment centers, and suppliers. They gain greater visibility of the fulfillment process. And, returns can be made to any location in the network, regardless of the order fulfillment point.

*“Distributed order management allows us to fill orders that, in the past, we would have lost.”*

## The Takeaways

DOM offers great promise for cross-chain visibility, integration, and service improvement. As with any technology implementation, the greatest benefits of DOM will be realized as retailers gain more experience and achieve integration with relevant systems. Through DOM, best-in-class retailers are achieving cross-channel control and alignment with their existing inventories and facilities.

*“The sustainable advantage will be found by retailers that understand how to use RFID data to improve the customer experience.”*

**Radio Frequency Identification**

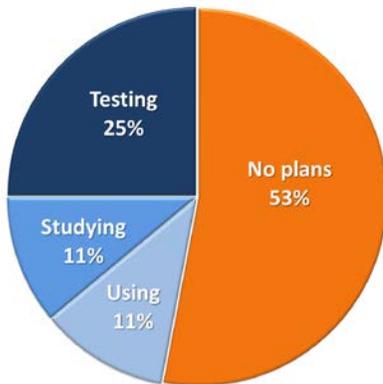
Over the last ten years, no other technology has experienced a wilder roller coaster ride than radio frequency identification (RFID). It has been alternately hailed as a great tool for retail fulfillment and panned as an overpriced luxury that does little more than much cheaper bar codes.

There have been high profile RFID pilot tests and rollouts since we identified it as a potential hot topic in the second annual SRSC Report.

In 2010, Walmart announced its plan to use RFID to track denim products and men’s basics inventories in its U.S. stores.<sup>4</sup> During 2011, American Apparel expanded its use of RFID, while JCPenney revealed that it initiated an item-level tagging program in three product categories. In 2012, Walmart will reportedly begin tagging women’s intimates, tires, and some consumer electronics. RFID plans have also been announced by the Gap and Macy’s.<sup>5</sup>

Among our research participants, RFID activity is strongest among supercenters, department stores, and drug stores. In contrast, grocers and home centers have limited interest in the technology. The overall activity level is presented in Figure 17.

Figure 17: RFID Implementation Status



Multiple factors – product type, cost, demand pattern, and need for replenishment – influence the RFID value proposition and deployment decisions. Another driver is the expected benefits and drawbacks of RFID use in the retail supply chain. Table 5 reveals that these expectations vary by level of RFID engagement.

Table 5: Anticipated RFID Impact

Status	Key Benefits	Key Impediments
Using	Labor costs Inventory accuracy	Tag costs Integration costs
Testing or Studying	Inventory accuracy Labor costs	Integration costs Hardware costs
Not using	SC visibility Inventory accuracy	ROI justification Data usefulness

As RFID drives greater accuracy, multiple groups benefit. The customer is protected from phantom inventory and reduced stock outs. The retailer needs less safety stock, improves ordering and forecasting performance, and reduces its need to conduct large-scale inventory counts.

*“We definitely see our inventory productivity and our in-stock levels improving without an increase in our cost to serve.”*

**The Takeaways**

Though RFID may not have the widespread appeal of a WMS, it can generate benefits in targeted applications such as apparel and high value consumer goods. RFID pioneers have sidestepped those daunting cost and ROI risks to gain valuable experience from their initial rollouts. If their overall success matches pilot test results, these leading edge retailers will improve in-stock availability, reduce supply chain costs, and increase customer service.

# On the Horizon

## Impending Issues and Opportunities

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*“Supply chain is such a great challenge. I love supporting company growth and trying to stay a couple steps ahead of where we need to be.”*

Retailing generates a never-ending to-do list, particularly in the supply chain area. Some topics, like regulation, fuel cost, and inventory/demand balancing, are perennial challenges. Other supply chain concerns appear and fade as economic conditions and the competitive landscape change.

During the interviews and again in the survey, we asked supply chain executives about their hot button issues. They articulated concerns that could generate great value or cause major stress during the next twelve months. Six of the most interesting topics are briefly reviewed below.

### Business Analytics

Key performance indicators, scorecards, and financial results have been on the radar screen of retail supply chain executives for decades. These business intelligence tools generate the visibility and insights needed to responsively manage fulfillment operations.

Leading retailers recognize the importance of becoming more proactive. They want to find meaning in the data – those insights into trends and root causes of problems – that can be used to drive planning and improvement activities.

These executives believe that business analytics will help them proactively address complex supply chain issues. Replenishment frequency, inventory optimization, and supplier collaboration are solid opportunities to engage business analytics tools.

*“To optimize performance across channels, you need disciplined processes and really good analytics. Retailers are investing heavily in it.”*

### Facility Automation

The aging American workforce, combined with the cost and physical challenges of manually selecting store orders, has numerous retailers evaluating their distribution center operations. They are reviewing opportunities to automate high-volume case picking operations to reduce costs, improve speed, and boost productivity.

Kroger and Sobeys have invested millions of dollars in highly automated distribution centers. Employees typically touch a product only on the receiving and shipping docks. Other high-volume retailers, intrigued by the potential efficiency gains, are actively evaluating the business case for similar investments. ROI and cost recovery time will factor heavily into these decisions.

*“We plan to do a proof of concept initiative around automated storage and retrieval to see if it fits our business model.”*

### Talent Development

While automation and technology are important, supply chain success requires talented people. Retailers must treat supply chain professionals as strategic resources that warrant significant investment. Leaders must determine the critical skills needed for success, where to source talent, and how to develop talent for advancement.

*“We have a pretty strong team but it’s time to prepare them to move into leadership roles.”*

As the economy and job market improve, the risk of talent flight increases. Forward thinking supply chain leaders are creating retention programs and establishing succession plans for key positions. Failure to do so will create a dangerous talent void.

*“Anyone that really understands the supply chain knows that it's easy to talk about and hard to do on a sustained basis.”*

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## **Risk Management**

Uncertainty creates risk for a business and these risks are magnified when uncertainty extends across multiple companies in a supply chain. Retail supply chains were significantly impacted when they were caught unprepared for the dramatic drop in demand during the recession. As a result, they were forced to cut spending without warning. This rapid change of course negatively impacted supplier and carrier partners.

*“They're proactively coming to us and planning a joint risk mitigation strategy to avoid any uncertainty around the season.”*

Risk management provides a tool to proactively deal with uncertainty such as a talent or resource shortage. Having a contingency plan to leverage third party capabilities and managed services helps retailers quickly adapt to volume surges, new markets and unexpected events. Risk management is not a new arrow in the supply chain executive's quiver, but it is one that is routinely underutilized.

## **Total Cost Focus**

Supply chain executives are acutely aware of the impact that transportation, order fulfillment, and inventory carrying costs have on a retailer. They are extremely adept at making effective trade-offs to optimize internal supply chain costs.

As retailers strive to succeed in hyper-competitive channels, a broader cost perspective is needed. Using the analytical tools mentioned earlier, supply chain leaders can take the lead role in developing a more sophisticated understanding of total company expenses and cross-chain cost drivers. This insight will generate opportunities to take money out of the supply chain without losing quality.

*“Our focus is holistic supply chain costing. What should the guy overseas do? What should I do in my DCs and what should stores do?”*

Supply chain executive are asking tough questions and leveraging stronger internal and external relationships to drive out cost. They are shifting responsibilities, managing from a margin protection perspective, and slaying sacred cows such as open-to-buy programs. The net results: cost and margin advantages.

## **Speed to Market**

There is a growing distance-time conundrum in retail supply chains. On the supply side, supplier-to-retailer distance can be vast. On the demand side, time is of the essence in direct to consumer channels. Supply chain leaders must develop speed to market solutions that alleviate this conundrum.

While expedited delivery is an obvious option, our participants believe that faster transport is not necessarily the optimal solution. The best response may be a multi-pronged effort that combines shorter design-to-production lead time, reduction of supply chain delays, and strategic use of nearshoring.

*“In documenting our end-to-end process, we began to see how much dwell time we create.”*

## **The Takeaways**

As retail supply chains become more advanced, the six issues discussed here represent some of the best near-term opportunities for supply chain executives to impact organizational success. We will monitor related activities during our next research cycle.

# Summary

## Final Remarks from the Third Annual Report

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Retail supply chains provided a solid operating foundation as retailers were encouraged by a growth in demand. At the same time retail supply chain executives had to wrestle with uncertainties derived from an uneven economic recovery, customer demand fragmenting across multiple channels, the impact of government regulation, and an evolving supplier base. Top SCM organizations navigated these complexities with grace and billions of products were delivered to store shelves and into customers' hands efficiently and reliably.

Supply chain executives continue to emphasize a balanced service/cost strategy and stronger cross-channel alignment. The best retailers understand that efficiency, effectiveness, and alignment are needed to succeed in today's competitive multi-channel retail environment.

Direct to consumer is the fastest growing retail segment and customers are increasingly taking advantage of the multiple ordering options. As demand shifts from in-store to online and mobile methods, multi-channel fulfillment becomes more critical to the success of many retailers. Multi-channel operations are made more complex due to the divergent mix of SKUs offered across channels. Top retailers are undertaking a strategic analysis of their current and emerging multi-channel requirements to determine optimal fulfillment strategies and align operations when possible.

Already globalized supply chains are becoming more distributed as suppliers move to new countries of origin beyond China. Savvy retailers are proactively collapsing their supply base to fewer manufacturing points in an effort to control the consistency of product on their store shelves. At the same time, the best suppliers are taking a larger role in strategic decision-making through supplier working groups and gainsharing.

Technology was a supply chain investment priority in 2011 as retailers worked to keep pace with increasing fulfillment complexity and maintain cross-chain visibility. Supply chain executives have invested in distributed order management tools to address the complexities of multi-channel order origination and multi-point fulfillment. Successful RFID pilots over the past two years have illuminated the path to greater value from this technology. Technology, along with process improvement, sits atop the spending priority list for 2012. Supply chain executives view these investments as solutions to narrow their multi-channel integration gaps.

As we look toward 2012, retail supply chains appear to be on solid footing and positioned to tackle the challenges on the horizon. Supply chain executives have become trusted partners and advisors to top management and other functional areas. The role of the supply chain executive and SCM will continue to gain status and be increasingly leveraged by the most successful retailers.

*"Supply chains are becoming more complex as businesses are seeking out opportunities; you need to be more nimble and capable of handling business in multiple forms"*

### Research Resources

<sup>1</sup> U.S. Department of Commerce, "Advance Monthly Sales for Retail and Food Service, December 2011," *U.S. Census Bureau News*, January 12, 2012.

<sup>2</sup> Anthony DeMarco, "NRF: 2011 Holiday Sales up 4.1 Percent," *Forbes*, January 16, 2012.

<sup>3</sup> Internet Retailer, *Trends and Data*, retrieved January 31, 2012 from <http://www.internetretailer.com/trends/sales/>

<sup>4</sup> Miguel Bustillo, "Walmart Radio Tags to Track Clothing," *The Wall Street Journal*, July 23, 2010.

<sup>5</sup> "Do JCPenney, Macy's Announcements Mean RFID to Finally Really Take off in Retail?" *Supply Chain Digest*, November 2, 2011.

# About the Authors

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Throughout his 18 year academic career, Dr. Gibson has been recognized as an innovative supply chain educator. He is widely engaged in corporate training, executive education, and distance learning programs. Dr. Gibson serves on the RILA Logistics Steering Committee, the CSCMP Professional Certification Committee, and is an Accenture Academy SCM content developer.

Dr. Gibson's academic experience is complimented by nine years of retail distribution management experience. He has published over 50 SCM articles and is author of the innovative video textbook *Operations: Managing Supply Chain Processes*. Dr. Gibson also serves as co-author of the market-leading textbooks *Supply Chain Management: A Logistics Perspective* and *Transportation: A Supply Chain Perspective*.



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Dr Defee's research efforts have been nationally recognized, most recently as co-author of articles that received best article of the year distinctions in the *Journal of Business Logistics* (2009) and *Transportation Journal* (2010).

Prior to entering academia, Dr. Defee was Chief Operating Officer for PFSweb, an international provider of outsourced distribution, customer care, and technology solutions supporting such clients as IBM, Hewlett-Packard, Nokia, and The U.S. Mint. He also spent 13 years with Accenture, where led consulting engagements for over 20 supply chain firms including The Walt Disney Company, Sears Logistics Services, Tandy Corporation, and Mary Kay Cosmetics.





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