FMCG Insights

AdvisorBase

March 2008

smarter decisions, better business

2008 — showing itself to be a testing year.

We are well into 2008 and a number of issues are establishing themselves as those that will challenge FMCG suppliers during the year.

- Primary freight will be the issue that comes to the fore early in 2008. Suppliers are vulnerable on many fronts and we have a full page on the topic overleaf.
- Increased pressure on trade spend plus an increasing proportion of sales on promo will test the alignment of pricing mix and product performance targets.
- Range rationalisation will add to the challenges of pricing appropriately across the whole range.
- Warehouse allowance and some efficiency terms such as merchandising appear to be issues that some suppliers will see addressed in '08.
- Cost to Serve issues will focus increasingly on understanding the drivers of customer and product profitability and developing effective route to market strategies.
- Pressures across the supply chain will focus attention on freight rate structures as suppliers seek to align new retailer primary freight with freight to other customers.

FGC Workshop

AdvisorBase is again privileged to be conducting a workshop for the FGC. The topics reflect the areas we consider to be of primary concern and interest during 2008.

The workshop in March focuses on four participatory, case study based, sessions dealing with:

Route to market – The best way to get product into the market is a strategic as well as cost driven decision and one that is always of relevance. The case study we use looks at both selling strategy and delivery options.

Performance based pricing – Supplier funded promotions are commonly the largest controllable expense that suppliers face after cost of goods sold, and are also an effective way of increasing sales. Taking a different perspective on trade spend can highlight areas of sub-optimality and areas for improvement.

Primary freight and factory gate pricing – It may look easy but there are real pitfalls. We will update developments regarding retailer involvement in primary freight, address the key issues and pitfalls and provide some practical advice.

Sustainability – Sometimes seen as a vague and difficult area to get to grips with, the workshop presents participants with a practical approach to addressing sustainability in a way that focuses on the key issues and renders them into terms that management can deal with.

March 18th, Crowne Plaza, Auckland

Field Sales Force Benchmarking

During last year AdvisorBase benchmarked the relative efficiency and costs of field sales for a number of larger FMCG supplier companies. While confidentiality and individual company performance was protected, companies learned their relative position and the drivers of that placing, with some surprisingly counter-intuitive findings.

Field sales is one of the largest components of Cost to Serve and many suppliers struggle with the trade-off between level of service and cost. Other benchmarking available provides feedback on the quality aspects of service delivery, but leaves unanswered the question "How much is enough or too much?"

The value of benchmarking depends on the validity of the comparisons being made. Measures such as gross sales per sales rep are pretty much invalid if the comparison is being made between companies with high and low value product or gross margin. We benchmarked the number of sales related personnel with the number of customers in the grocery and non-grocery sectors. In grocery, the number of customers is determined by the number of supermarkets – a very solid basis for comparison – in the non-grocery sector customer number reflects the route to market strategy of the supplier.

The benchmarks uses efficiency rather than effectiveness measures to reflect the level at which a suppliers services their customers. While this can be influenced by the velocity of the category a supplier operates in, that variable can easily be isolated and accounted for. Irrespective of category, the supplier is still making the decisions on strategy, structure, call frequencies, and seniority of the reps.

For more information regarding this benchmark and what is needed to be involved contact Jeremy Howcroft at AdvisorBase on +64 (0)21 434 082

The real question the benchmark addresses is ***route to market***. At the heart of the sales strategy debate is the extent to which the mechanism of service delivery actually affects sales. Knowing how costs and service levels compare with competitors, suppliers can assess the "quality return" they are getting and perhaps investigate an alternative sales strategy or route to market.

Primary Freight

Primary freight – the most significant event for industry suppliers and carriers since Woolworth's acquired Progressive?
2007 ended with Foodstuffs Wellington writing to suppliers seeking logistics information to be used to decide on the viability of Foodstuffs entering the primary freight arena. It now appears Foodstuffs will embark on the initiative on a national basis.

What is primary freight?

The pivotal differences between the proposed primary freight models relate to what the retailer is actually doing.

- The retailer provides the primary freight carrier for the suppliers. They are paid for the freight by the supplier via a freight contract, charge or rebate. We call this a **Primary Freight Arrangement (PFA)**. This is the basis for the models used by Coles (a national rate per SKU) and Woolworth's (freight rate by route) in Australia with both deducting primary freight from remittances albeit using different calculations.
- Alternatively a retailer can provide the primary freight carrier at their own cost, taking delivery and ownership of a *reduced list price product* at the supplier's warehouse. This is **Factory Gate Pricing (FGP)** and has not been adopted in Australia, perhaps because it transfers future freight risk to the retailer.

It should be noted that there are real differences between the situation in New Zealand and Australian and drawing a simple parallel may not serve anyone's interests.

It would be useful for the industry if a single model were adopted. The models have different implications and suppliers should not be indifferent to which is adopted.

The issues

A retailer becoming a supplier's primary freight provider (supplier warehouse to retailer distribution centre) is much more than simply changing the name on a freight contract. Suppliers are effectively acquiring a new freight provider for life – no ditching them on price or performance grounds.

Industry level issues:

- Selecting the primary freight model to adopt (PFA or FGP).
- The overall project is most likely to succeed with a co-operative approach between suppliers as a group and Foodstuffs or better still with both major retailers.
  - This is a change that everyone will have to work hard at getting right the first time.
  - Once a retailer the size of Foodstuffs establishes primary freight, reverting to the current arrangements at some future date will not be easy.
- Establishing a mutually acceptable approach to determining financial considerations.
  - Avoid suppliers 're-inventing the wheel' through a common methodology
  - Provide the retailer with a consistent approach to suppliers
- Establish an 'honest broker' role to:
  - Attest to the validity of supplier data while preserving a confidentiality shield for supplier freight arrangements and overall volumes quantities and other commercially sensitive information.
  - Share supplier – retailer learning. The retailer learns from each primary freight experience, but suppliers only from their individual experiences. An 'honest broker' working with multiple suppliers addresses this problem sharing supplier experiences.

Individual Supplier issues:

- Being prepared for negotiations with a good appreciation of:
  - Cost to Serve, specifically freight cost drivers
  - Discount and rebate structure and calculation basis
- The interlinked nature of prices, discounts and rebates usually result in a range of changes to best accommodate primary freight.
- Getting the numbers right, an inappropriate starting point or assumptions can easily produce a material disadvantage to a supplier that endures for the life of the relationship.
- This as a multidisciplinary issue involving sales, finance and logistics, in that order!
- The impact on logistics operations (e.g. warehouse location, freight arrangements)
- The costs for delivered product and the implications for route to market strategy.

Adopting primary freight will require a significant investment of resource by suppliers involving input from many parts of the business if the risks are to be recognised and avoided.

Useful links/resources:

Primary freight primer:
http://www.advisorbase.com/whitepages.htm

Primary Freight Considerations—general overview:
The FGC has a helpful summary of the main points to consider, "Primary Freight Considerations" is available for members to download
http://www.fgc.org.nz/members/Resource_Library/supply_chain.asp

Specific advice or assistance with primary freight:
Charles Wilson: +64 (0)21-899-166 or Advisors@Advisorbase.com

General comment and discussion:
The AdvisorBase forum has been re-launched as a moderated blog [http://advisorbase.blogspot.com/] providing a platform to exchange information and views (under a pseudonym if you like) on this and other topics.

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