



RetailWeek
CONNECT WHITE PAPER

In association with



Super charge your supply chain visibility

How retailers can save millions by taking back control



INTRODUCTION

Achieving end-to-end visibility in a multi-tier manufacturing supply chain is notoriously difficult. For many retailers it's the Holy Grail – constantly strived for but rarely achieved.

In today's fast-paced retail environment, having complete control of the entire supply chain network is a strategic imperative, with a single slip in awareness potentially having devastating reputational and financial consequences.

One key area where retailers are struggling to attain visibility and control is in the relationships between their primary manufacturers and component suppliers. In fact, it's estimated that retailers who can't properly police their manufacturers' component sourcing have up to 85% of product components sourced from unapproved suppliers – meaning they may lose 85% of the rebate money they should be collecting from approved suppliers, equivalent to millions in revenue.

This white paper, produced by *Retail Week* in association with Segura, explores the implications of failing to achieve full end-to-end visibility and what you can learn from retailers who have been stung. Find out how to side-step the risks associated with rogue sourcing and the vital ways to achieve maximum business savings by optimising your rebate potential and supply chain visibility.

“Having complete control of the entire supply chain network is a strategic imperative”



CHAPTER 1: WHY SUPPLY CHAIN VISIBILITY MATTERS

Having good visibility as far down the supply chain as possible drives down costs, ensures a reliable flow of good quality products and allows companies to achieve their ethical and environmental goals. But when it is not there it can lead to disruption in supplies and, worst of all, damage to the company's reputation.

It is particularly vital at a time of increasing legislation, such as 2015's Modern Slavery Act. This requires companies with a turnover of more than £36m to publish an annual statement showing the efforts they are making to eradicate slavery or trafficking in the supply chain.

The size of the challenge was underlined recently when clothing being made for several companies known to have strong policies on ethical sourcing was featured in a BBC *Panorama* programme.

Syrian refugees, the youngest of whom was 15, were shown making garments for Marks & Spencer in a Turkish factory for low rates of pay and being paid in cash. This was despite previous visits by M&S to suppliers, which had revealed no evidence of Syrian workers being employed. M&S is now working with the supplier to take remedial action including offering permanent legal employment to the Syrians involved.

These incidents arose despite strong efforts being made by M&S to create an ethical supply chain (see box). A statement released by M&S said it expected suppliers to adhere to a set of global sourcing principles: “We do not tolerate such

breaches of these principles and we will do all we can to ensure that this does not happen again.”

In the same programme an Asos sample was found in an unauthorised sub-contractor's factory employing refugees and underage workers. The company subsequently visited the factory and has committed itself to support the young workers in returning to school and has ensured that the adult refugees are paid the minimum wage.

A statement from Asos chief executive Nick Beighton underlined the need for supply chain visibility. “The issues *Panorama* raises aren't with our approved factories, who we audit. It's with unapproved outsourcing to factories we don't know about. This will continue to be a problem until we know where every garment is made and, however difficult, that's what ultimately we've got to achieve,” he said.

Lessons from Rana Plaza

The Turkish situation is not the first time that supply chains have been shown to have included unwanted practices. The collapse of the Rana Plaza factory in Bangladesh, which supplied several fashion brands, resulted in the death of 1,135 people in 2013. In the same year a factory in Dewsbury, Kozee Sleep, which made beds and mattresses that were supplied to major retailers was found to be using trafficked Hungarian men in its workforce.

Peter McAllister, executive director of the Ethical Trading Initiative (ETI) – which



works with its retail, manufacturer, trade union and voluntary group members to implement a base code of practice – says that not taking action to improve supply chain practices is no longer an option.

“Some companies might have been happy to deal with the first tier supplier without knowing too much about the rest of the supply chain. Those days are now gone,” he says.

McAllister says it is too early to assess the impact of the Modern Slavery Act but welcomes the fact that annual statements must be signed off at board level. “There is now at least a discussion at senior management level, if there wasn’t one before,” he says.

At the moment, the level of supply chain visibility is patchy. According to the *Supply Chain Resilience Report*, published annually by the Business Continuity Institute (BCI) and Zurich Insurance Group, 66% of companies do not have full visibility of their supply chains and 40% do not analyse the original source of any disruption that occurs.

“To have a clear view of your supply chain would enable you to respond and recover”

Patrick Alcantara, BCI

Patrick Alcantara, BCI’s senior research associate, believes that this can prevent adequate action being taken to solve an issue. “To have a clear view of your supply chain would enable you to respond and recover,” he says.

But he adds: “Companies sometimes have hundreds and thousands of suppliers and keeping track of them all is quite a challenge.”

SUPPLY CHAIN VISIBILITY: HOW BIG IS THE PROBLEM?



2 in 3 companies **do not** have full supply chain **visibility**



41% of **disruptions** occur at **Tier 1** suppliers



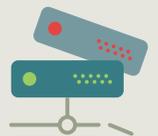
2 in 5 companies **do not** analyse the original cause of supply chain disruptions



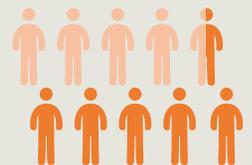
7 in 10 companies **experienced disruptions** in the past 12 months

The three main causes of supply chain disruption

1 Unplanned IT and telecomms **outage**



2 Loss of talent or skills



3 Cyber **attack** and data breaches



Source: Supply Chain Resilience Report 2016 by Business Continuity Institute and Zurich Insurance Group

RETAILER EFFORTS

Many retailers welcome the Modern Slavery Act as part of a wider ethical and environmental policy that often relies on improving supply chain visibility.

Louise Nicholls, Marks & Spencer's head of responsible sourcing, describes the Act as "game-changing". As well as meeting its requirements, M&S published an inaugural Human Rights Report outlining its policies in June. This commits the company to advance human rights throughout its business, including its extended supply chain by 2020.

Nicholls says the retailer already explains to existing and future suppliers their roles and responsibilities and carries out audits to assess progress. There are regional conferences where the company's policies are discussed and where case studies are highlighted. "We can show best practice and highlight upcoming issues," she says.

Often when problems are found the

company will try to work with the supplier to rectify it or if it is a more widespread issue in a country it will work with other companies to try to solve it. "It's all about understanding the root cause," Nicholls believes.

For example, in 2015 poor accommodation and worker-management communications were found in a UK fruit packing house. Instead of ceasing to use the supplier M&S worked with it to improve conditions. In Ethiopia, M&S found that a lack of childcare facilities meant that parents employed in a co-operative were bringing young children to work to sit with them while they graded coffee. As a result a safe crèche area was created in conjunction with the co-operative.

Other retailers are making similar efforts. Audrey Blancart, ethical trade manager of The Body Shop, says that the company tries to build close relationships with its suppliers. "Whether they are down the road

from us in the UK or from overseas it's about working with the supplier in a fair and consistent way."

The company's Community Trade programme encourages sustainable practices among its suppliers and also education and health among the workforce. There are 19 suppliers involved but The Body Shop plans to increase this to 40 by 2020.

John Lewis Partnership is also committed to tackling modern slavery and works closely with suppliers to raise labour standards and improve working conditions. But it also monitors its supply chain from an environmental perspective.

Benet Northcote, director of corporate responsibility, comments: "We work with our suppliers to trace raw materials in our own-brand products back to source including leather, palm oil, soy, timber and paper."

The Body Shop's Community Trade programme encourages sustainable practices among its suppliers

CHAPTER 2: THE BENEFITS OF REBATE OPTIMISATION

Supply chain visibility is vital when maximising the commercial relationship between retailers and suppliers, especially when it comes to rebates.

For manufacturers – the first tier of the supply chain – these can be a powerful tool to incentivise the retailer to promote and sell particular products and to reap part of the rewards. For component suppliers – the second tier – they can be instrumental in funding sourcing and supply chain initiatives that ensure that nominated suppliers get the maximum order volumes, and orders are not leaked to unapproved, possibly unethical,

suppliers. Roy Williams, managing director of procurement and supply chain consultancy Vendigital, explains how they work.

"They typically involve suppliers making retrospective or even upfront payments – 'pre-bates' – to major customers in exchange for specific commercial returns.

"When handled in an open and honest way, based on parameters that are mutually beneficial, rebates can be an effective way to strengthen partnerships. Problems can arise, however, if the rebate fails to deliver any meaningful commercial benefit for the supplier and is simply an opportunistic tactic

used by the customer to leverage its position of commercial strength."

Mark Davis, international director of sourcing at The Body Shop, says rebates work well in the context of a transparent supply chain with good supplier relationships. "They need to be linked to targets for growth within the business and come into play when you hit those targets," he says.

Kosten Metreweli, chief marketing officer of supply chain visibility software firm Segura, adds: "It's a way for everyone to share in the success of a brand. It is not just a way to fund marketing programmes. A

well managed Tier 2 rebate programme can improve manufacturer sourcing compliance, which raises quality and ethical standards for the brand, and in return delivers a big uptick in orders to nominated component suppliers.”

However, in a world where most retailers will have hundreds of Tier 1 suppliers (who manufacture branded goods on behalf of the retailer) and a mixture of direct and indirect relationships with possibly thousands of lower tier suppliers, identifying and claiming back everything that is owed can be extremely difficult.

Policing the supply chain

Segura estimates that a lack of supply chain ordering visibility means that retailers who are attempting to force Tier 1 manufacturers to only source components from approved or nominated Tier 2 suppliers can achieve as little as 15% compliance by manufacturers. If they use rebate with those nominated suppliers, that means that they are losing up to 85% of their potential rebate entitlement.

The problems can occur when the Tier 1 supplier does not order components from nominated Tier 2 and Tier 3 suppliers – as agreed in their contracts – but goes into the market to find cheaper sources, often at the expense of quality and ethical standards. This means that the volumes, and therefore incomes, achieved by the lower tiers are less than expected and that rebates for the retailer are correspondingly lower.

Alternatively, the lower tier suppliers can under-report what their sales were and therefore claim that they should pay less in the way of rebates. With hundreds of such suppliers this can be hard to police.

Metreweli says the use of specialist IT systems and knowledge of how to recognise the warning signs can massively reduce such problems. For example, any discrepancy between what was ordered from the Tier 1 supplier and what they subsequently order from component suppliers could indicate a

M&S worked with its supplier in Ethiopia to create a safe crèche for employees bringing children to work



“Investing in making the supply chain as transparent as possible is something that will bring real commercial benefits”

problem – if 10,000 shirts have been ordered from a Tier 1 supplier, a corresponding amount of buttons or labels should have been ordered by the Tier 1 supplier from the nominated lower tier suppliers – if not – where have those components come from?

Using such software, companies can map their supply network and designate nominated suppliers, including which product or component they provide. Retailers can then trace each order as it fans out down the supply chain in real time and drill down if they suspect a problem.

There are other benefits from having full visibility and making sure that components are being ordered from the right place. “If, for example, a zip is being ordered it needs to be from a quality manufacturer otherwise you

are running the risk of it breaking which could potentially leave you with a massive – and expensive – returns problem,” Metreweli says.

The company has found that in some cases compliance in ordering from nominated suppliers can be as little as 15%. On average there is 60% to 70% compliance, which still means about a third of the components in a brand’s products are of unknown provenance.

Non-compliance can create serious difficulties for some companies owing to the complex nature of their supply chains, says Sue Butler, director of management consultant Kurt Salmon. “Full supply chain visibility ensures that all key dates are being adhered to, that the volume requirements are being met,” she says.

Having full product visibility of all component parts also allows retailers to aggregate their requirements into one order which they can use to support negotiations. “We have seen retailers save between 1% to 3% on the cost of their component parts by having this visibility,” Butler says.

For those who can get it right, investing in making the supply chain as transparent as possible is something that will bring real commercial benefits.

FINANCIAL IMPLICATIONS

Managing commercial income, including rebates, can be a difficult area for retailers, both in achieving full visibility and to judge which accounting period in which to place the revenue.

To increase transparency, some retailers have begun to include information about them in their annual report.

- Morrisons recorded an increase in supplier rebates from £134m in 2015 to £143m in 2016 but another type of commercial income from marketing and advertising fell from £291m to £260m.

- Sainsbury’s recorded a decrease in supplier rebates from £88m to £69m and also for another form of income, fixed payments for in-store

promotional or for using specific space. These fell from £551m to £302m.

“The year-on-year reduction has been driven by the conscious decision to move away from supplier arrangements and towards a reduction in the base cost of goods,” Sainsbury’s stated in its annual report.

The ability to forecast such incomes for the next year can be very difficult without good visibility, according to Segura’s Kosten Metreweli.

“From a CFO point of view you know you should be getting a certain amount of revenue. But if that is entirely variable due to low compliance levels your ability to forecast accurately is jeopardised,” he says.

But not all retailers believe that rebates are beneficial. The chief executive of one leading fashion brand says it prefers to plan up to 12 months in advance with suppliers who benefit from the company’s overall growth. Rebates are only used in the case of significant unanticipated growth and are the equivalent of 0.1% of sales.

“Supply chain visibility is high on our agenda. We see our suppliers as strategic partners not just as service providers. By working with them as partners we build longer term, mutually beneficial relationships, have greater transparency in the supply base and get early sight of any issues so they can be managed effectively,” the chief executive says.

CHAPTER 3: LOOKING TO THE FUTURE

Globalisation has already had a huge impact on the supply chain but its effect is likely to become more pronounced in the future. Companies with large, complex supply chains will need to build transparent relationships with trading partners.

This can be difficult and daunting and, at first, there could appear to be a conflict between sourcing products at the lowest cost and meeting ethical and environmental responsibilities. There is evidence, however, that these aims go together, as long as there is transparency throughout the chain.

As well as avoiding potential reputational damage having good visibility is good business practice, the ETT's Peter McAllister believes, particularly when it comes to areas such as quality control. "Keeping your eyes closed is never a good way of running a business," he says.

With the kind of reputational damage that can result from bad practices being unearthed in the supply chain, the ethical aspects of the supply chain are indistinguishable from commercial ones, according to Vendigital's Roy Williams.

"From a supply chain management perspective, retailers must make ethical criteria part of every buying decision and make sure these considerations remain in focus when commercial considerations come to the fore," he comments.

In order to make this happen they may need

to look at how the supply chain is structured. "Retailers and other businesses should seek to simplify their supply chains as far as possible and invest time and resource in getting to know suppliers and understanding the practices and products they are using," Williams says.

Relationship with suppliers

Mark Davis of The Body Shop also believes that choosing suppliers with the right attitude to ethics and the environment makes commercial sense. The company's approach is to use long-term suppliers with whom there is a strong partnership. Davis says that the company has been working with some suppliers for more than 20 years – minimising the risk of supply chain disruption.

"We believe that helps us get the best quality ingredients and, if a product flies off the shelf in the stores, the suppliers will prioritise our business," he says. "The cosmetics industry is anyway quite capital intensive in terms of R&D and production capacity so there is not much change in the supply base."

There is a similar attitude at Marks & Spencer, according to Louise Nicholls. "Working in partnership with suppliers is fundamental to how we do business. Trained people are more productive and without any doubt better working conditions result in better products being delivered on time," she says.

There are also benefits environmentally and the company measures the financial impact of its Plan A sustainability policies. This is calculated by adding the cost savings resulting from using less energy and other resources to the revenue from its M&S Energy operation and then subtracting the investment in the Plan A programme. This amounted to £185m in 2015/16, up 16% on the previous year.

In order to achieve this kind of benefit, retailers need to monitor activity as far down the supply chain as they can. However, this will vary from product to product, according to Kurt Salmon's Sue Butler.

"Increasingly supply chain visibility for leather products is starting in the field and the same is happening with cotton, but not many fashion brands would look to be identifying the source of the raw material that goes into making the shirt buttons," she says.

"In grocery it has become an imperative that retailers know the complete supply chain. This enables them to understand and mitigate any risks, identify any end-to-end cost savings and also be able to monitor supplier performance against KPIs."

Marlow Truman, consulting retail supply chain lead at Deloitte, says companies are increasingly seeking visibility down to raw material level as a way of making the overall supply chain more efficient. This could involve sharing promotion plans more effectively or, in the food sector, changing recipes to make better use of abundant ingredients without affecting the final product.

"This requires increased trust and partnership with the suppliers, alongside more complex and longer term commercial arrangements and better information sharing," Truman says.

Segura's Kosten Metreweli believes that consumers will increasingly demand to know the provenance of their product and where it was made. This has already happened with some retailers giving detailed information about products such as meat and eggs but the desire for this will become more pronounced, he believes, especially among the younger generations.

"Millennials, particularly, are demanding a guarantee that products are sourced ethically and not just at the luxury end of the market but for value items as well," he says.

"We are likely to see a day when a customer can scan a product with their mobile phone and find out its ethical and environmental history. That would create an incentive to buy products and create a race to the top among brands."

Increasingly, it would appear, supply chain visibility is becoming a prerequisite for good business – both now and in the future.

TRANSPARENT SUPPLY CHAIN BENEFITS

Management consultancy Accenture has identified a 'triple advantage' of a simultaneous improvement in commercial performance, environmental performance and support for local economic development that result from having a transparent supply chain.

Gary Hanifan, managing director and operations strategy lead for Accenture Strategy, says this is the result of working closely with suppliers: "What you find is that you discover better, faster and cheaper ways of doing things."

Companies can act together to develop the brand and generate revenue, reduce costs, improve its ethical reputation, as well as mitigating any risks from disruption. So how do they go about doing it?

1 "The first step is to create real-time visibility so that you know what is happening and how to react to it," Hanifan says.

2 "The next step is then to use predictive analytics beyond simple reporting and create 'what if' scenarios."

Protecting against disruptions in the supply chain is a question of analysing where the supply chain is most vulnerable. "It doesn't just mean working with 1st Tier companies, it could be 2nd or 3rd Tier – if just one small component is missing it can hold up production," Hanifan points out.

Accenture has worked with the World Economic Forum to analyse 31 supply chain practices and judge what effect the 'triple advantage' approach would have. Their joint *Beyond Supply Chains* report found there was:

- Revenue uplift of 5% to 20%
- Supply chain cost reduction of 9% to 16%
- Brand value increase of 15% to 30%
- Significant risk reduction
- At the same time there was a carbon reduction of 13% to 22%
- Plus improved wages and conditions for workers.

PARTNER COMMENT

It seems incredible that in a world where we can seemingly access any information at any time from our mobile phones, it still isn't possible to guarantee the provenance of the components of the goods we buy.

Yet the impact of not knowing is immense – ethical and environmental bad practices are allowed to thrive, inefficiencies drive up costs and elongate production cycles, and quality is compromised.

Most brands are in the infancy of understanding their extended supply chains, and in many cases do not recognise the scale of the problem that they have.

The need to drive out costs, as well as pressure from non-governmental



organisations, consumers and government legislation to improve ethical practices is forcing that to change.

Recent exposés of bad ethical practices have tended to focus on tier 1 product manufacturers – yet these are just the tip of the supply chain iceberg.

In many cases these factories are really just assembling components from deeper in the supply chain – so where were the cotton, labels, buttons and thread of a shirt sourced from?

Many brands have taken the step of nominating tier 2 component suppliers to ensure quality and compliance – and yet even the biggest brands have great difficulty forcing their manufacturers to comply with this policy.

For brands that use rebate – this can have the added impact of millions in rebate revenue being left on the table. The key problem here is complexity – you can't manually ensure that every component of every product of every order you place on a manufacturer is being fulfilled from your nominated or approved suppliers perhaps several steps down the supply chain.

We think it is time all that changed. Several trailblazing retail brands are now leading the charge to use new technology to get visibility of the source and journey of every component of every product they sell, in real time, and are realising immediate financial and ethical benefits.

• **Kosten Metreweli, CMO, Segura**

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SEGURA'S KEY POINTS

- Start with a map – you can't manage what you can't measure. Map all of your Tier 1 manufacturers and subcontractors then move down to your Tier 2s and beyond. Consider going all the way to raw materials for high risk components.
- Nominate suppliers – start to nominate suppliers for specific classes of component, extend your audit regime to cover them, and communicate the policy to tier 1 manufacturers.
- Benchmark – If you're already using nominated suppliers, run spot checks to see what percentage of total order volumes suppliers actually receive.
- Introduce closed-loop control – start to trace how each order you place flows down the supply chain and ensure that component ratios are correct at every step.
- Put a remediation plan in place with non-compliant manufacturers – and be prepared to cut them lose if need be.

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