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Supply Chain Management in a Wal-Mart World

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The Wal-Mart supply chain management structure is not one size fits all. How do you keep everyone else happy? Apply service differentiation to your strategic accounts.

by Jonathan Byrnes

Here's a supply-chain dilemma: Now that you've learned how to do business with Wal-Mart, what do you do with everyone else?

Over the past decade, Wal-Mart has famously invited its major suppliers to jointly develop powerful supply chain partnerships. These are designed to increase product flow efficiency and, consequently, Wal-Mart's profitability.

Many companies have stepped up to the challenge, starting with the well-known Wal-Mart/Procter & Gamble alliance, which incorporated vendor-managed inventory, category management, and other intercompany innovations.

P&G even fielded a dedicated account team in Bentonville, AR. In a very creative approach, the team members represented key P&G functions: sales/marketing, distribution/supply chain management, IT, and finance. In the eyes of one P&G vice president who was centrally involved at the time, Wal-Mart's CFO became a key customer as P&G's objective became maximizing Wal-Mart's internal profitability.

Increasingly, top managers have learned how to integrate their supply chains with major customers like Wal-Mart. (For an example from the hospital supply industry, see my column, "Profit from Customer Operating Partnerships.") Much has been written about the need to develop customer partnerships, and most companies have at least one project in this area. What most companies have not sorted through, however, is what to do with all of their other customers.

Now what?

A common answer to the question of how to structure relationships with other customers is to try to apply the Wal-Mart relationship to all customers. This approach is implicit in commonly shown PowerPoint slides that offer a view of a company's evolving supply chain role. In one version of this view, the company starts as a stable supplier, evolves into a reactive supplier, then an efficient reactive supplier, then an efficient proactive supplier, and finally becomes a "revenue and margin driver."

Developing Wal-Mart-like supply chain partnerships requires a lot of resources and management attention.

This seems logical, with the company's supply chain capabilities inexorably increasing in sophistication over time, enabling the company to develop ever more effective integration with its customers.

The problem, however, is that developing Wal-Mart-like supply chain partnerships requires a lot of resources and management attention. It also requires willing, innovative partners. Pursuing this approach too widely would be both costly and frustrating.

In the past, suppliers to the retail trade typically had rather monolithic supply chains. The order fulfillment process was designed with a "one size fits all" approach. Customers generally received the same list price regardless of ordering efficiency. There was very little effective forecasting. Some inventory priority was given to major customers in the event of allocations. Products were delivered in the manner that customers requested, regardless of the inefficiency entailed.

Today, the retailers themselves are changing dramatically. There is very visible consolidation, with the top ten retailers expected to comprise about half of the industry's revenues in a few years. Retailers have very different degrees of willingness to innovate, and the innovators are growing fast. Most retailers were used to having significant buyer power, and many are still very focused on exerting price pressure on their suppliers rather than seeking increased profitability through process innovations. At the same time, the leading retailers are consolidating their supplier bases. They are looking more and more to major suppliers for supply chain innovations and prioritization, and in return, they are giving them increasing shelf space.

As a result of this history, major retail suppliers find themselves stretched. They are forced to meet the increasing needs of their largest customers while they are devoting disproportionate resources to their smaller customers. This untenable situation is forcing major suppliers to rethink their account relationships and extended supply chains.

The importance of service differentiation

The key to providing excellent, consistent service at a reasonable cost is service differentiation. This is a process in which a company sets different service policies, such as service intervals, or delivery times, for different groups of accounts and often products. The company always keeps its delivery promises, but the promises are different to different groups of customers. I wrote about this in my column, "The Dilemma of Customer Service."

This concept can be adapted to guide the development of an appropriate set of broader supply chain policies. It is essential to successful profitability management, because it enables a supplier to match its cost structure and innovation initiatives to account potential.

Service differentiation is also good for the customers. It enables them to plan their operations around a very high and consistent level of service. However, it does require that customers establish well-disciplined operations, as the supplier should adhere to a specific set of agreed-upon processes.

The sea changes that retailers and their suppliers are now experiencing are starting to play out in industry after industry.

Service differentiation matrix

The service differentiation matrix depicted in Exhibit 1 provides a way to organize and structure account relationships. In this 2x2 matrix, account size is represented on the vertical axis, and willingness to innovate is represented on the horizontal axis. The horizontal axis also could represent growth, as aggressive innovators almost always are the highest growth companies.

The matrix has four cells: (1) strategic accounts are major accounts with a willingness and ability to form integrated supply chain partnerships; (2) integrated accounts are large accounts, important but often somewhat smaller than strategic accounts, with less willingness to join in supply chain innovations; (3) emerging accounts are smaller accounts that are very innovative and generally fast-growing; and (4) stable accounts are smaller accounts that are generally reluctant to innovate significantly. Each account cluster requires a very different set of account relationships and supply chain structures.

Strategic accounts. These major accounts both warrant and require a high degree of integration, customization, and innovation. This is manifest in two main areas.

First, the supplier and the strategic account should develop an aligned, long-term business strategy. This typically involves a three- to five-year year shared strategic plan for the relationship, and joint long-range planning. The relationship should be innovative and involve shared risk. For example, one strategic account wanted to develop a process for picking up product at a major supplier's factories, rather than having it shipped from the distribution centers. Although this was a new, and potentially costly, way to do business, the supplier was willing to develop a unique process to make this work. As another example, several major suppliers are working with their strategic accounts to pioneer Auto-ID, a new supply chain technology.

Second, the companies' supply chains should be fully integrated. This should involve both supply chain processes and systems. Replenishment should be continuous, often involving vendor-managed inventory, rather than discrete orders. Some suppliers are pioneering efforts to develop new vendor management processes and systems that extend all the way to the retailer's shelf, rather than to the distribution center. For strategic accounts, the supplier should dedicate cross-functional account teams and expend significant amounts of resources to understand the account's structure and business.

Integrated accounts. These important accounts warrant significant care and resources, but not extensive customization. This can be seen in two areas.

First, a major supplier and integrated account should develop an aligned business plan and scorecard. The joint business plan will not be as customized as in the case of a strategic account. The plan should have a shorter time horizon, perhaps one year, and the relationship should be collaborative and trustworthy.

Second, the companies' supply chains should be aligned and coordinated, but not necessarily fully integrated. The supplier should use existing internal processes to respond to orders from integrated accounts. Vendor-managed inventory systems may be appropriate for these accounts, as they are a cost-saving measure. However, new systems that would bring vendor management to the store shelf may not be warranted.

Emerging accounts. These smaller accounts are very innovative and fast growing. They warrant significant supplier attention both because of their growth, and because they provide a low-risk opportunity for the supplier to develop new systems and processes. Yet, because they are small, there needs to be a limit to the investment.

The supplier should provide service that is both functionally excellent and flexible. The service must be efficient and largely standardized, or costs will quickly go out of control. However, the supplier often can justify meeting some unique needs, especially if the innovation can be scaled to the larger account base. These accounts are important because they force the supplier to push the innovation envelope.

Stable accounts. These accounts typically cause a disproportionate supply cost because many are unsophisticated and have idiosyncratic processes. For example, a stable account may order by fax rather than EDI, and may have unusual shipping specifications.

The key to supplying this group profitably is to offer a menu of service offerings, along with clear rules of engagement, such as minimum order sizes for various lead times, weekly ordering, and shipments to distribution centers only. In this way, the supplier can provide very reliable, consistent, cost-efficient service. This will ensure transactional efficiency for both the supplier and customer.

It is likely that the supplier will need a transition strategy for this segment of accounts. This process will be easier if major suppliers adopt similar standards and procedures. Some major suppliers already have chosen to serve some of their stable accounts through master distributors.

How it plays out

The sea changes that retailers and their suppliers are now experiencing are starting to play out in industry after industry. The evolving retail supply chain provides a model for top managers in these other industries as they face the seemingly impossible dilemma of providing excellent service while maintaining profitability in the presence of escalating customer demands.

Service differentiation also poses a crucial new management task: providing different types of service to different clusters of accounts with a limited set of operating systems. In a later column, I will talk about how to accomplish this.

By the way, what do you do with everyone else? The answer is: Meet their precise needs by not trying to be everything to everyone!

See you next month.

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Exhibit 1: Service Differentiation Matrix

<table>
<tr>
<td rowspan="2">Account Size</td>
<td>Large</td>
<td>Integrated Accounts

• Aligned business strategy and scorecard
- Collaborative, trustworthy actions
• Process-driven alignment
- Coordinated supply and demand chain
- Dedicated resources when the business case warrants</td>
<td>Strategic Accounts

• Aligned, long-term business strategy
- 3-5 year joint long-range planning
- Innovative
- Shared Risk
• Fully integrated
- Integrated supply and demand chain (process and systems)
- Dedicated cross-functional teams
- Approach opportunities through the eyes of the customer</td>
</tr>
<tr>
<td>Small</td>
<td>Stable Accounts

• Reliable service
- Consistent
- Cost-efficient
• Menu approach to product and service offerings</td>
<td>Emerging Accounts

• Functionally excellent service
- Flexible
- Innovative
• Some unique needs met
• Pioneer scalable innovations</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td></td>
<td></td>
<td colspan="2">Account Willingness to Innovate</td>
</tr>
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