

Digital disaster

Sainsbury's put a sophisticated automated supply chain in place to help make it the market leader again, but instead produced the first loss in the company's history. Liam O'Brien reports

Stock availability is about as basic as it gets in the world of supermarket food retailing. Retailers call it the "first moment of truth" for the consumer. If the store has not got the product on the shelves, the customer cannot buy it. And if the retailer cannot sell it, it misses a sales and profit opportunity. Along with competitive prices and short queues at the checkout, stock availability is one of the three "musts" for grocery chains. Fail at one of these and you will start to fail as a retailer.

This is a lesson that the once-mighty Sainsbury's has learnt to its cost. Last month it announced the worst pre-tax results in its 139-year history - a first-half loss of £39 million, its first ever loss - largely as a consequence of poorly stocked shelves and a failing supply chain. It has been a long, hard fall for the store, which was the UK's leading supermarket as recently as the mid-1990s.

Despite spending £3 billion on a sophisticated supply chain meant to satisfy shoppers and help the retailer to regain lost ground on thriving competitors such as Tesco and Asda, it had to admit that "it could not deliver to the required scale". Its supply chain was helping to drive the company to a net loss for the full financial year with worse stock availability than before the investment.

New automated depots were "failing to perform at the planned levels" and leading to unsatisfactory stock availability. Problems are such that "additional manual support" is to be introduced where systems are "failing". Chief executive Justin King told shareholders that he was moving back to basics by taking on 3,000 more shopfloor staff and writing off much of the supply chain investment.

"Retail is a simple business," he told shareholders. "We've made it much too complicated. There are too many people creating that complexity. We're going to have a slimmed-down central function that focuses on serving our colleagues in stores."

The about-turn has been dramatic given that, only a matter of months previously, King's predecessor, Sir Peter Davis, had been championing the company's new supply chain as its saviour in his "business transformation programme". It was going to help claw back the lead Tesco had secured to relegate Sainsbury's share of the market to 15.3 per cent (Tesco has a 28 percent share and Asda has 16.9 per cent). By pruning a network of 25 distribution centres to just nine facilities in eight regions in the UK and building four giant warehouses - two of them fully automated - for £400 million each, Sainsbury's had hoped to catch up and overtake its rivals.

Its failure to achieve this is the latest cautionary tale in how supply chain problems can hobble retailers.

US supermarket chain Kmart filed for bankruptcy in large part as a result of poor product availability; Mothercare's profits have been badly hit by problems at its Daventry distribution depot; and food wholesaler Booker has experienced long-running problems with its Heartland centralised distribution system, which cost the company £150 million and added to its losses in 2003.

Amanda Aldridge, head of retail at consultancy KPMG, has worked with Sainsbury's and Waitrose. She says: "Within a retail environment, supply chain is absolutely critical. The supply chain is where retailers have been looking to drive

out cost savings, but this is pretty dire if it means 'stock outs'. Having plenty of product at one end of the chain but none of it where it matters - on the shelves - can make or break a company."

Sainsbury's and its recently joined supply chain director, Lawrence Christensen, was unwilling to be interviewed for this feature, but retail analysts believe there are key lessons that will be learnt along the high street from the Sainsbury's debacle.

The first of them is the danger of implementing technology too quickly. The initial timeline for the retailer's supply chain project, when it was conceived, was seven years, but as its share of the market continued to dip, the decision was taken to complete it within three years. And instead of an incremental switch to new automated systems, all hope was placed on a "big bang" approach, with much of the new functionality coming on stream this summer.

Other retailers have successfully implemented more automated systems but have been careful to employ a gradualist approach. It is an industry given that getting technology to work from day one is impossible when replenishment systems, warehouse systems, transport and supplier purchasing have to synchronise around products that have a short lifespan.

Paul Smiddy, retail analyst at investment bank RW Baird, says: "Instead of a step-by-step approach, Sainsbury's went for a sort of big bang and found out that it was worse off than before it introduced the new system.

"They might as well have employed men with donkeys and carts. Sainsbury's has rivals that have reasonably automated picking systems and they seem to work, such as those at Ocado (attached to Waitrose) and Iceland, so it can be done."

Irrespective of the time frame, the technology looks to have been too ambitious. The automated systems that have been put in place are undoubtedly state of the art and, in theory, capable of handling 2.5 million cases a week from around 2,000 suppliers and delivering them to more than 500 outlets each day (see Features, 18 September 2003).

Once delivered to the automated warehouses, goods are placed on a conveyor system, which includes a high-speed cross-belt sorter, 2.25 miles of belt conveyor and 25 automated storage and retrieval cranes. Barcode readers check goods and the information is fed straight into the warehouse management system.

The cruel truth, however, of having such high-tech equipment is that it has been leading to poorer stock availability. A survey, carried out by the Sunday Times and published in October, of 20 Sainsbury's stores across the country showed that in some stores only 19 out of the 30 products on a shopping list of everyday items were actually in stock.

In an echo of Kmart, where mega-distribution centres could not keep stores fully stocked, Sainsbury's four large distribution centres have not been up to fully supplying the retail outlets. As a consequence, an old depot scheduled to close has been reprieved and an already-closed facility at Buntingford, Hertfordshire, is to re-open.

Super-sophisticated supply chains can save companies millions of pounds, but if they go wrong they can also mess things up spectacularly.

An intense emphasis on technology is seen as a recurrent problem in retailing, particularly when it comes to supermarkets. Self-scanning, intelligent trolleys and customer relationship programmes have all been used by stores but all come well down the list of consumer wants.

John Davison, vice-president and research director at business analysts Gartner G2, says: "There is no point to technology unless it serves customers. It is often a case of sticking to the basics, and in the case of retailing that is competitiveness, availability and short queues.

"Sainsbury's is not the only one. Look at Safeway before the Morrisons' takeover in March. It was a lame duck because it had taken its eye off the ball. As it happens, it was also interested in new technology. It was one of the first into customer relationship management and self-scanning."

Alongside the hardware in place at the automated warehouses, software had been designed for Sainsbury's that was intended to minimise stockholding and put deliveries on a more "just-in-time" footing.

The intention was to give the chain better control of supplier-to-store replenishment, as well as cutting replenishment time and stockholding.

Sales forecasting became centralised and was integrated with warehouse management. The retailer invested heavily

in data mining tools to extract and extrapolate information gathered from its reward-card scheme.

What surprises others in the industry is that Sainsbury's thought such software could work, given the fact that food retailing encompasses many more variables than other products, and higher stockholding is regarded as a necessity.

Robert Brent, supermarket analyst at KBC Peel Hunt, says: "Accenture (its technology consultants) delivered a system for food retailing that was far too exacting given the variables. It was trying to use a just-in-time system with food where there are just too many uncertainties involved.

"The system works, but basically it has no latitude; it can't take any fluctuations. Food retailing is not an exacting science: how can you design a programme that can factor in, for example, the weather?

"The others have kept, by and large, to traditional methodologies and they realise that you cannot take JIT beyond a certain level."

The intricacies of sales prediction were compounded by Sainsbury's so-called high/low model of pricing. Instead of the EDLP - everyday low prices - model employed by the likes of Asda and Morrisons, it pursued more of a value-driven approach in which low-priced promotional items are sold alongside less competitive products.

Such a model makes running out of stock more likely when combined with the highly predictive, JIT model of stock replenishment used today compared with traditional sales-based replenishment.

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In a quest to continually reduce inventory to the barest minimum, retailers have become highly dependent on the accuracy of their predictive sales modelling and, some argue, have convinced themselves that they have higher availability than is actually the case. Most will state that it is in the region of 95-97 per cent, but consumer experience on the high street indicates that it is often much lower in reality, with a predictable impact on their satisfaction.

Gartner G2's Davison says: "Sainsbury's, like others, has almost given up on sales-based ordering. Along with other retailers, it has convinced itself that it has higher availability than it actually has.

"You only have to look at the surveys to appreciate that customers are not satisfied with the availability that they are getting across the board. It is a question of going back to basics for retailers."

Many maintain that the poor implementation of the new supply chain systems was a symptom rather than a cause of its present problems, and the underlying factor, as with all retail malaise, was senior management losing sight of the retail plot. In the case of Sainsbury's, the problems had been building for at least the past 10 years and started when the chain failed to match the investments being made by rivals, Tesco and Asda. Davis's unveiling of his "business transformation programme" three years ago may have been a case of trying to do too little, too late.

The management has been cooking up plans to revitalise the business for the past decade, yet the result has been relentless decline.

One of the reasons for this, according to analysts and competitors, is Sainsbury's stipulating that suppliers should deliver to its new warehouses only on specially designed pallets, markedly different in size to the industry norm. They question how so much faith could be placed in technology, given the vagaries of food retailing. And they ask whether it was advisable for Sainsbury's to place so much reliance on the management consultants who designed the new automated system.

Peter Carefoot, supply chain development manager at the Co-op Group, says: "At the end of the day there were people at Sainsbury's who felt that the risk was worth taking. We looked at automation 12 months ago and decided it was too risky.

"The trouble with the automated route is that you put all your eggs in one basket. If the system does not work there is no back-up and you are stuck; you can't go round and manually pick."

Robert Brent adds: "It sounds like the management did not understand fully what it was trying to do. Someone must have realised that what they were trying was not really feasible.

"Given the time many of their managers have been in the business, you'd have thought that they would have guessed that it was too ambitious. It baffles me."

Retail management tends to follow what is termed the "wheel of retailing" cycle. During the early stages of a business, management identifies well with the store's customer base, but as the business grows it develops a

head office function that becomes progressively more removed from customers. As a consequence, head office managers implement initiatives that make sense at head office level but have no customer benefit.

Justin King hopes his decision to axe 750 staff at Sainsbury's glass-and-steel head-quarters in London will turn the wheel forward and put the chain back in touch with its customers and on a more profitable footing. The rest of the high street will be watching to see if this can be done.

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