

Retail with detail

Love it or hate it, Tesco is the UK's biggest retail success story. Charlotte Dennis-Jones examines how procurement has played its part

Four thousand, eight hundred pounds a minute. That's how much money supermarket giant Tesco made during the past financial year. This astounding 12-month, £2.6 billion profit performance announced last month broke all previous records.

Newspapers devote acres of coverage to the UK's biggest retailer. It is as likely to be praised for its business strategy as it is criticised for its rapidly growing power, which is currently under scrutiny by the Competition Commission. But, like it or loathe it, Tesco deserves admiration from its retail counterparts. Achieving such financial success demands business acumen of the highest degree.

In an interview on the day of the results, chief executive Sir Terry Leahy made it sound simple: give customers what they want and you will be successful. "Anyone knows if they go shopping and they're not looked after they go somewhere else, and many do," he said.

Every retailer knows they have to give customers what they want, but that does not mean they always do. Take availability, for example. How frustrating is it when a garment is not available in your size, or the shelves are devoid of that crucial ingredient?

Retail buying mistakes also pose many challenges. If a range has been misjudged not only will it not sell, but the store is likely to get a reputation - at least for that season - for not hitting the mark.

While there are many reasons for Tesco's success, without finely honed procurement and supply chain strategies it would not be where it is today. A key part of keeping

customers content is buying the right products and making sure they are on the shelf when they want them.

So, how does Tesco do it? And are there any areas in which even this top performer could improve?

Procurement's Role

Speaking at the World Retail Congress in Barcelona in March, Leahy stressed the importance of ensuring procurement is consumer-led. This may sound logical, but the extent to which Tesco listens to its shoppers, watches what they do, and analyses this information is second to none. And it is prepared and able to adapt quickly to meet changing needs.

Leahy believes there are several consumer trends which will continue to have an enormous impact on product procurement. These include:

Simple choices: "Life is becoming more complicated and stressful. We have all got enough to do without having to make a whole series of extra decisions each time we buy something. Companies won't prosper by making things more complicated or offering ever more confusing options."

Saving time: "People are working later so they want to be able to pick up something on the way home. So, that means more products that save time - ready meals or snacks which can be eaten on the run."

Immortality: "People are increasingly concerned with their health. We have seen a big move away from high-fat, high-salt products matched by an increase in their lower-fat, lower-salt alternatives."

By monitoring closely any shift in consumer sentiment (particularly with online shopping and Clubcard data), Tesco has ensured its buying professionals deliver the goods.

Good procurement is "crucial to the business", explains a Tesco spokesman. "If it's not customer-focused you're not going to get anywhere. Our buying teams are similar to those of any other supermarket, but we ensure that what they buy is generated from the customer end," he says.

For example, it plans to bolster its upmarket food ranges in a bid to attract more affluent shoppers who might otherwise be drawn to the likes of Waitrose.

Relationships with Suppliers

At the other end of the equation are the suppliers and all supermarkets are currently under scrutiny for their buying power. They are often suspected of putting too much pressure on suppliers by demanding longer payment times and greater discounts.

As the most powerful UK retailer and a growing international force, Tesco has the potential to exercise considerable clout over the thousands of manufacturers that stock its shelves.

Yet at the congress in Barcelona, Leahy stressed maintaining good relationships with suppliers is critical to keeping customers. "If a retailer has a problem with a supplier on the other side of the world, customers will hear all about it in double-quick time and expect to know what you are going to do about it," he said.

Then again, suppliers are unlikely to criticise their retail customers outright because no one can afford to lose a major contract.

A Tesco spokesman says accusations that it exerts too much buying power are unfounded. "It can't work that way and it doesn't. Our market share is sometimes grossly overstated. Yes, we're a big player but no, we can't do what we want." He adds the Competition Commission and its predecessors have always found it to have a "good symbiotic relationship" with suppliers.

"Every now and then it goes wrong and the media is keen to capitalise on that, but we have an inherent need for a good supply base because without that you can't innovate and without that you can't grow," he says.

If Tesco only hounded suppliers for cost reductions and promotional deals (a cost the supplier picks up), vendors would not have money to invest in research and development to improve products -which reflect well on the retailer.

One example of Tesco working alongside its suppliers was last month's announcement of a £25 million investment into the UK dairy industry. It will give milk producers a significantly higher price, without passing on that cost to consumers, and farmers' contract prices will be reviewed every six months to ensure they reflect the costs of production.

"We know that some UK milk producers - often through no fault of their own - have had a very difficult time for a number of years. Our customers tell us they are not comfortable with this and they want us to help if we can,"

says Richard Brasher, Tesco's commercial and trading director.

So it responded to consumer demand, suppliers benefited and Tesco got a nice PR boost.

The move even pleased the National Farmers' Union. President Peter Kendall described it as "the most significant and encouraging development in the dairy industry for a long time."

Troy Warfield, UK general manager of manufacturer Kimberly-Clark, which supplies tissues and nappies to Tesco, says the retailer's simplicity - giving consumers what they want and being clear about what it wants from suppliers - is "part of its beauty".

"Tesco has delivered a clear strategy execution for a number of years. It's consistent, focused on shoppers, does everything with clarity and relates that back to its suppliers," he says.

Be it Terry Leahy or a retail buyer, their way of thinking and communicating are aligned, he explains, which simplifies the relationship between the two businesses and enables the manufacturer to manage its own supply chains and supply teams accordingly.

So has Tesco become keener on price as it has gained power? "Tesco, as with all retailers, is looking at how to provide best value and we try to do that too," replies Warfield.

Dave Flack, director of Catalus, which supplies digital memory cards to Tesco, says dealing with a retailer of this size keeps a supplier on its toes.

"Tesco has the resources to pretty much do what it wants and it's got the entrepreneurial spirit behind it. That can be quite challenging for us."

Nevertheless, he cannot fault Tesco for the way it does business. "As an organisation it understands what it wants and its processes make it straightforward to deal with. It also understands our pressures and we have a great deal of flexibility in the way we handle it."

Simple systems include the ordering process, where Tesco is clear about what it wants, from whom and when. In terms of flexibility, suppliers say Tesco does negotiate on price and isn't unreasonable if it makes mistakes that result in a cost for the supplier.

Flack adds he has seen a change in the retailer over the years. In the early days of its contract - about seven or eight years ago - it was dealing with a technological product that was quite difficult to understand. As such, Tesco didn't want to invest in a buying team or product manager in that area.

"We started off as category managers, helping it to understand which products did what," he says. "But as the sales grew Tesco recognised the size of the opportunity and wanted to become more competitive. And as the products have become more competitive, we've found there has been a much greater pressure on pricing than before."

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Increasingly, Catalus has to prove and break down the costs of its supply chain to justify its prices. "While Tesco is happy for us to make money, it doesn't want us to make too much because it eats into its margin."

Tesco's growing global presence, not just in terms of retailing but also sourcing, is another consideration. The retailer has set up a Hong Kong operation for sourcing products supplied by the likes of Catalus. "It's imperative for us to maintain in-depth knowledge and offer it something it can't find itself and this will become more and more challenging in the future," says Flack.

Logistics Made Simple

Buying the right products and maintaining supplier relationships is only part of the equation. Equally essential is getting goods to stores on time. Retail logistics are notoriously complex because stores deal with hundreds of thousands of suppliers from all over the world. And rapidly changing consumer trends mean they have to respond to demand at lightning speed, so short lead times are crucial.

Tesco's logistics operation is such a well-oiled machine that other retailers want to learn from it.

Scott Wharton left his role as Tesco network development director to join food retailer and distribution company Musgrave Budgens Londis as supply chain director. He says there is "undoubtedly" a correlation between Tesco's supply chain efficiency and profit. "This is both from a cost-efficiency perspective and from the value added to the core business," he explains. "We all know of retailers who have suffered when they have availability issues. Even with

the huge growth of Tesco during the past decade, the pace of development of the supply chain has ensured this has not been a limiting factor in supporting the business."

He says the Tesco model works particularly well because of its flexibility to support customer demand and the simplicity of its operational model. "If it's simple and visible, it's controllable," he says. "Complexity leads to errors."

Wharton is applying this model to the Musgrave brand: "The success of Musgrave is intrinsically linked to the success of our independent retailers, and the delivery of supply chain excellence to offer the best availability at lowest cost."

Paul Cunningham, managing director of supply chain consultancy Holistica, has previously worked with Tesco on a distribution network project. He was impressed by what he saw. "From the top down it sets clear projects, objectives and timescales and it manages those closely."

Tesco should be applauded, he adds, for the way it has managed to maintain an efficient supply chain during years of rapid growth, both domestically and internationally. And a few years ago its non-food merchandise was non-existent.

Much of this is sourced overseas, so in a relatively short time it has set up an entire global sourcing supply chain.

"This is a big achievement on a large scale," says Cunningham. "Accelerating global sourcing brings risk and Tesco has managed that well."

It has also mastered the art of looking at its entire supply chain to improve efficiency. "It is able to match demand very closely with supply even though its supply might be in China. That's not easy to do."

He adds its supply chain development teams are particularly adept at managing the total supply chain cost. By structuring the chain and operating it at certain costs at source, it is able to have a positive impact on price and availability downstream.

Online Shopping

A Tesco spokesman says that, while availability is never going to be perfect, the supermarket is leading the industry.

Of major importance in achieving this has been the launch of its online transactional website. Orders are fulfilled by the stores' picking teams, so staff are even more acutely aware of what is on the shelves and in what proportion. And, unless dealt with efficiently, online shopping can give rise to more customer complaints.

"If our delivery van shows up for a customer who has ordered 40 items and two are missing, they are not going to be happy. But if we don't have the exact washing powder they want in store they might not even notice. Online shopping has driven us even harder because visibility is even higher."

Last year Tesco topped the supermarket rankings for pre-Christmas website availability. According to research from internet performance company Keynote Systems, its site recorded an availability of 99.47 per cent over five days. In

comparison, Ocado, which is part-owned by Waitrose, came bottom of the league, with an average availability of 93.8 per cent.

Is there any room for improvement in Tesco's logistics operations? Like any other business, it is not infallible. Flack says during peak times of the year, booking-in teams who arrange the deliveries to the distribution centres can be over-zealous.

"Sometimes we have to incorporate enormous waiting times that do have a cost-implication, and we have to take that into account when pricing. However, everything is open to negotiation," he says.

Kimberly-Clark is working with all of its supermarket customers, not just Tesco, to improve availability. "When issues arise it can come from supplies being short or not having transparency between the supplier and the retailer, or it can be a problem in store, such as systems," says Warfield.

At all retailers, even where availability is high, there is always room for improvement and it is everyone's responsibility, he adds.

Where Next?

In the future Tesco will be looking further afield. It has already opened its first store in China, in Beijing.

The next major phase in its steady march towards global power is its impending expansion into the US. Under the trading name Fresh and Easy Neighbourhood Market it will open at least 20 stores of 10,000 square feet in

Phoenix, Arizona; Las Vegas; San Diego and Los Angeles. It will spend US\$400 million a year in the country for the next five years as it expands.

Will it pull this off with ease? Providing sourcing and logistics strategies are applied with the same refinement as its UK operations, the track record of the retailer with the Midas touch indicates it will do more than a good job. Charlotte Dennis-Jones is features editor at Retail Week

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