Supply chain leaders, such as Wal-Mart, Supervalu and Tesco, are changing the rules.

By Kathleen Hickey

Who's Winning The Supply Chain Game?

Food retailers are on an acquisition spree. According to industry experts, grocers are looking to own, or at least manage, as much of their supply chain as possible. Some are taking the extra step of becoming third-party logistics providers to competitors.

The reason? Those with the best control of their logistics network will be the most successful today and tomorrow.

"Every company we work with is 'right-sourcing'," or re-aligning their logistics operations, says Ed Frazelle, president and CEO, Logistics Resource International, Atlanta.

Two primary drivers for this trend are trucking capacity shortfalls and fuel costs, says Frazelle. Other drivers include market fragmentation, internationalization and consolidation.

"The industry is evolving very quickly, into a distribution system that is much more tiered or segmented to different customer needs," says Bill Bishop of Willard Bishop, Barrington, IL.

"You can go upscale very easily and downscale within a short distance of your home, compared to 10 or 15 years ago."

The fragmentation reflects the actions of consumers, who are shopping at a wide array of stores, regardless of income.

The trend of internationalization is affecting the food supply chain as well. While international goods are a smaller percentage of goods sold than other supply chains, the shift is changing food retailers' supply chain structures.

"Truly one thing that people aren't factoring in is that the food business is going global on a scale that people don't grasp," says Bishop.

"I bought an ice cream novelty item in Chicago that was made in Latvia—a frozen dairy product. Part of it is economics and part of it is pizzazz."

Consolidation is another pressure affecting logistics operations purchases. While many retailers continue to operate the same way they did in the 1970s, those that don't change with the times will face extinction. The trend of consolidation will not only continue but increase in the coming years, says Richard Kochersperger, an educator in the department of food marketing at St. Joseph University's Erivan K. Haub School of Business, Philadelphia.

Kochesperger estimates that Wal-Mart will represent one-third or more of the American food supply chain within the next 10 years. "They opened 69 stores one day in January," he says.

A solid supply chain "will make or break a food retailer," says Frazelle. "A food retailer is essentially a logistics company and a real estate company put together with a little bit of marketing. Logistics costs are a huge portion of costs. From the service side, if you don't have product customers won't come to the store."

The Wal-Mart Factor

While some experts saw this logistics purchasing trend beginning last year, others believe that it all started with Wal-Mart as long as 10 years ago. "Wal-Mart is the dominant story and everything is a reaction to them," says Kochersperger.

Ron Ireland, one of the people responsible for developing the legendary replenishment and forecasting system at Wal-Mart Stores, contends that retailers are scrambling to do today what Wal-Mart achieved years ago. Ireland worked at Wal-Mart for nine years as a strategy manager overseeing a team of programmers and currently is managing principal at business management firm Oliver Wight Co.

"A lot of grocers haven't invested in technology the way Wal-Mart has. Most are at least five to seven years behind. Many are trying to catch up to where Wal-Mart was years ago," including logistics operations ownership, says Ireland. Wal-Mart owns most of its logistics network.

In fact, both Supervalu and Wal-Mart control such a large portion of the U.S. food supply chain that their extensive leverage is what is driving other retailers to in-source their logistics operations, says Frazelle. "Because Wal-Mart and Supervalu can sway capacity as they need it, they get first dibs and other retailers are left out in the cold."

Kochersperger estimates Wal-Mart's share

Tesco May Take U.S. Market Share From Wal-Mart

While Wal-Mart is renowned for its supply chain prowess, it isn't the only player in town. In a few years Hertfordshire, England-based Tesco PLC may be beating Wal-Mart Stores at its own supply chain game in the United States.

The food retailer, the world's fifth-largest retailer with reported sales of approximately $67 billion in 2005, recently announced plans to enter the U.S. market in 2007 with a unique store plan similar to smaller grocery stores in Europe.

"Tesco will be a very big challenge to Wal-Mart. They execute very well and are Wal-Mart's closest competitor," says Ron Ireland, managing principal at Oliver Wight Co.

Initially the two chains will not compete. Wal-Mart is the number one retailer worldwide, with annual sales of $312 billion last year, and focuses on a large store format that is not competitive with Tesco's smaller grocery store format. Tesco will need to spend several years building its brand and U.S. supply chain before it can set its sights on competing with Wal-Mart, says Scott Langdoc, an analyst at consulting firm AMR Research Inc., Boston.

Still, "Wal-Mart should be concerned. Because if Tesco has initial success with its new store formats, new to the United States, there is nothing to keep it from exploring larger store formats, including its hypermarket. Any hypermarket is a direct competitive threat to Wal-Mart," says Langdoc. "Tesco doesn't have the public relations baggage that Wal-Mart has. One could presume that Tesco may have an easier time expanding into larger store formats in places where Wal-Mart was resisted simply because it isn't Wal-Mart."

BATTLE CRY: Tesco is entering the United States with its Express small-store format.

Both Wal-Mart and Tesco have similar supply chain capabilities and knowledge, say experts. "Tesco is awesome. They are probably as good as anyone. They are not intimidated by anybody," says Richard Kochersperger, professor of food marketing at St. Joseph University.

Kochersperger predicts Tesco will become a threat in a decade. If it purchases Kroger's then it may gain U.S. market share sooner.

Tesco is entering the U.S. market on the West Coast with a small-store format, called Express, that is different from convenience store and traditional U.S. grocery formats. While Tesco's initial competition will be with traditional grocery stores, including Kroger's, Safeway and Albertson's (soon to be acquired by Supervalu), at 3,000 square feet the store format will be much smaller than traditional grocery stores.

"These are grocery store strategies that other grocers do not focus on," says Langdoc. "It is an area that is underserved in food retailing today in the U.S."

With its Express concept, Tesco will be targeting consumers who like to get in and out of the grocery store quickly. The store will carry a mix of fresh food and groceries, different from most convenience stores.

Langdoc believes Tesco's ace in the hole will be its merchandise mix, which has a significantly higher percentage of private-label items than traditional U.S. grocers. U.S. grocers traditionally have between 10percent to 15 percent of their goods as private label, or store-labeled, items. Tesco in theUnited Kingdom and other locations has more than 50 percent of its goods as private label, he said.

With such a high percentage of private-label goods, "there is a major upside and downside. If their private label is as well-received as it has been in other countries—it is a very profitable merchandise line to sell. The downside is nobody knows Tesco," and so the company's private label could fail in the United States, says Langdoc.

But Langdoc doesn't see failure in Tesco's U.S. future. "I personally believe that Tesco's private-label strategy will be one of the major linchpins of success in the U.S.," he says. "Because Tesco will be able to rapidly respond to what the customer wants," and at the same time achieve a higher level of profit than other grocers. *—K.H*

Supervalu, TLC Creating A Super Strategy

Supervalu Inc. has started its supply chain acquisition spree. Today it isn't just a food retailer, it's also a third-party logistics provider, thanks to its purchase of Zeeland, MI-based Total Logistics last year. The largest U.S. wholesaler, based in Minneapolis, is building upon its extended logistics network to offer grocers and food manufacturers an alternative way to move their goods.

Richard Kochersperger of St. Joseph's University says the acquisition could be significant, particularly because manufacturers have not been good at managing their inventory in transit. "That is a good strategy if they can make the cultures work," he says.

The strategy isn't for every food retailer, though, as it depends on the financial conditions of the company, he adds.

At the time of the acquisition, Jeff Noddle, chairman and CEO of Supervalu, said, "We have been looking for the right partner to obtain critical mass and solidify our commitment to third-party logistics...The combination of Supervalu's scale and supply chain competence together with Total Logistics and its nationally recognized reputation in third-party logistics will unlock growth opportunities."

That growth may be commencing this year as Total Logistics, through its subsidiary 3PL, Total Logistic Control, or TLC, offers its services to other food retailers and manufacturers, says Bob Koerner, president and CEO of TLC.

The 3PL has revamped and expanded its network to include the ability to move goods through parts of Supervalu's extensive supply chain, "which none of our 3PL competitors can do," he says.

Customers using TLC will have access to a nationwide logistics grocery network. "The big (grocers) have fairly sophisticated supply chains. But tier two and down don't. One concept we are working on is being able to offer the mature supply chain capabilities of a company like Supervalu to smaller companies through TLC. And use the parent company's supply chain," says Koerner.

Yet TLC's network will remain separate from Supervalu's. TLC's core focus will be on growing its 3PL business with Supervalu and some expansion may occur as Supervalu acquires many of Boise, ID-based Albertson's grocery operations. Currently about 95 percent of TLC's business is non-Supervalu.

Supervalu purchased TLC because "they wanted the third leg on a stool—retail, wholesale and 3PL," says Koerner. "Logistics is a core business for Supervalu."

TLC, founded in 1902, is a national logistics provider with services including refrigerated and dry warehousing, transportation, supply chain management, facility and operations management, food distribution, bottling, packaging and fulfillment. Eighty-five percent of the company's business is food related. The company operates from 39 locations across the country.—*K.H.*

of the food supply at $130 billion, with the overall retail supply chain at $500 billion. "That is one of the most remarkable achievements in American food," he says.

Because of Wal-Mart's technology investments, its inventory accuracy is above 96 percent, while most food retailers are at around 70 percent, says Ireland. Wal-Mart has improved in-stocks, reduced holding inventory, reduced manual intervention and achieved much greater profit margins, he says. With such improved cost management, Wal-Mart can afford to make more investments in its logistics operations than other retailers.

"People say Wal-Mart is not a great retailer but a great supply chain," says Bob Koerner, president and CEO of Total Logistic Control (TLC), a third-party logistics subsidiary of Supervalu in Zeeland, MI. "You don't go to Wal-Mart for the shopping experience."

Fortunately there isn't one way to achieve supply chain success. Wal-Mart has a cost-driven supply chain and is "relentlessly experimental," says Bishop. "I don't think anyone can match in that area. The disadvantage is it doesn't allow them to be as fine-tuned in what they deliver."

By contrast, Supervalu has a traditional supply chain, says Bishop. "They are very good at what they do and are making big investments in the next level of warehouse automation."

All agree that collaboration is key. "This is because the model for creating business value is changing. Companies today participate in extended supply chains, where real operational efficiency and revenue enhancement can only come from greater visibility, integration and synchronization among connected partners," says Ralph Drayer, founder and chairman of Hilton Head Island, SC-based Supply Chain Insights, a consulting firm, and a former vice president at Procter & Gamble.

A successful supply chain needs to be customer-focused, flexible, timely, financially accurate and damage-free, says Rick Blasgen, president of the Council of Supply Chain Management Professionals (CSCMP), Oak Brook, IL. Blasgen held logistics positions at Nabisco and Kraft prior to his appointment to CSCMP late last year.

"The common focus of reducing out of stocks is a battle cry that all can rally around. Whether you're a manufacturer, retailer or wholesaler, this remains the ultimate opportunity for all to jointly work toward," he says.

Frazelle contends the way to achieve these goals, and the reason for the logistics purchasing trend among food retailers, is because they "need to be even closer to the customer."

Food retailers "need to have more distribution centers rather than less to combat transportation costs and be close to the customer," says Frazelle. "The other issue that is driving the number of distribution centers is congestion in cities. People are congregating in megopolises. These megopolises are where 80 percent of the population lives. And traffic congestion is increasing. It takes longer to travel."

Increasing supply chain customization will also drive logistics operations purchases, says Bishop. "There is not going to be a single supply chain" for a store—a mushroom supply chain will be different from candy canes, he says. Packaging will also be in many sizes, from goods sold in large cases at stores such as Costco to individual serving sizes sold in convenience stores.

The key element to achieving this customization will be a supply chain "that allows the product to move as far as it can in the system in a larger, untailored fashion," says Bishop. Final tailoring will happen closer to the consumer.

In order to achieve these goals, "We are going to find some strange (supply chain) partners. Meaning that competing companies...will work together to lower costs. Even the big guys," says TLC's Koerner."