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How retailers can take supplier collaboration to the next level to combat margin pressure

It's no secret that the US retail landscape is shape-shifting, presenting tough challenges for industry players: Rising inflation and labor costs. The ever-increasing need to invest in multiple sales channels so customers can have the seamless experiences they demand. Mounting price pressures from Amazon and off-price stores.

All of those forces are eating away at already razor-thin profit margins. And the situation has catalyzed what some observers call the retail apocalypse—an unprecedented number of store closures and bankruptcies.

In 2017 alone, the amount of retail space announced for closure reached a record 105 million square feet, and 2018 is shaping up to set another record. Indeed, by the end of August, 94 million square feet had already been announced for closure. The numbers reflect in part the shift to online shopping. But a recent bankruptcy wave—which includes such well-known names as Toys R Us, Bon-Ton, and rue21—figures into the mix as well.

Supply-side pressures have only made things harder for retailers. Commodity prices have climbed, with cotton hitting a five-year high in June 2018. A few months before that, Australian wool prices reached a historical peak. This price inflation comes at a time of intensifying trade tensions and the potential for additional tariffs on products imported into the United States from China.

STRATEGIES FOR COUNTERING MARGIN PRESSURE

In an effort to combat the trends, companies have once again sharpened their focus on sourcing as a way to generate much-needed cost savings. However, as everyone knows, retailers also expect to achieve those savings without compromising product quality or delivery speed. If anything, they aim to enhance performance on those two fronts as they slash costs. But how?

Traditionally, sourcing managers have shifted countries of production as their primary means of driving margin. For some time now, the shift has been away from China and into emerging countries or such places as Bangladesh, Vietnam, and African countries, including Ethiopia.

Yet implementing that kind of change can be a long and painful process fraught with risk. Do it too quickly, and product quality can suffer, along with delivery speed. At worst, retailers risk making social, environmental, and regulatory missteps. And that can earn them the ire of customers who care as much about compliance on those fronts as they do about product quality, cost, and delivery.

What's more, the wage differential between sourcing countries (adjusted for productivity) has narrowed, because established locations like China have achieved new efficiencies through automation while wages in emerging countries have spiked. Take Myanmar. In early 2018, the government of that Southeast Asian nation approved a whopping 33% hike in the minimum wage. At the same time, land costs there have risen. And the result is that as many as 14 apparel factories decided to close their doors.

In addition to taking the traditional approach of shifting countries of production, many retailers have begun using digital tools to sharpen their competitive edges. Indeed, across the retail industry, technology has fueled the explosion of e-commerce and the rise of new players armed with radical operating and business models.

In the realm of sourcing, retailers have adopted digital tools such as product life cycle management solutions. Some have also started testing the next wave of digital technologies—including 3-D sampling and raw material tagging—with an eye toward cutting product development costs while enhancing speed to market. To be sure, digital is front of mind for companies in most industries today, with some retailers viewing it as the solution to all of their sourcing woes.

For that reason, retailers should resist that all-too-common temptation to adopt technology simply for technology's sake. Instead, they must keep a laser-sharp focus on the value they're getting from their technology investments. For instance, is a particular tool enabling the company to achieve process efficiencies and other competitive advantages in the realm of sourcing that are sufficient enough to justify the investment? And does the company have a clear road map for capturing maximum strategic value in sourcing from digital tools?

Without a focus on value and with no understanding of how digital would benefit a company's sourcing efforts, a digital transformation program could quickly turn into a seemingly bottomless money pit.

PARTNERING UP WITH SUPPLIERS

How can industry players best mitigate demand- and supply-side pressures, successfully manage country-of-production shifts, and generate maximum value from their digital investments? Two words: supplier collaboration. Historically, suppliers have concentrated solely on excelling at manufacturing. But recently, many of them have reconfigured their business models by adding services their clients value, such as in-house design and development and inventory management. At the same time, suppliers have invested in improving their production efficiencies as well as the quality and consistency of their products.

Such increased sophistication offers a major opportunity for retailers to forge strategic, mutually beneficial partnerships with their suppliers. For example, a shift in country of production becomes a lot less risky if you're working with a long-term supplier that's ramping up production in an emerging country—compared with hunting down a brand-new supplier. Similarly, you can extract far more value from your technology investments when you and your supplier adopt similar digital tools.

Of course, many retailers already collaborate in certain ways with their suppliers. For instance, it's common practice to conduct supplier-specific business reviews and to hold annual supplier summits aimed at communicating general company objectives and handing out supplier awards. But in today's challenging landscape, supplier collaboration must advance to a whole new level. Retailers and their suppliers have to cultivate an environment of trust in which they can freely exchange crucial information that will uncover shared priorities they can then tackle together.

With that vision in mind, we've been working with retailers to set up Supplier Partner Councils (SPCs). An SPC assembles a small group of a retailer's most-strategic suppliers: those that are on the cutting edge or that have unique business models and that are invested in the retailer's brands and long-term objectives. Such suppliers may—or may not—be the largest in annual volume purchased by the retailer.

The SPC then helps the retailer prioritize and implement joint initiatives critical to its own long-term performance as well as that of its strategic suppliers. For example, we set up an SPC for one retailer that worked with its supplier community to select a 3-D sampling solution and roll out a quality-control supplier certification program.

For Supplier Partner Councils to provide tangible value over time, a retailer must answer a number of questions, such as:

- Who are the right supplier partners for us?
- How often should we meet with our strategic suppliers? How do we maintain momentum after the initial meeting?
- How frequently should we reconfigure our network of supplier partners, and what criteria should we apply for making such changes?
- How should we prioritize joint projects, and which partners should we work with on which types of projects?
- How do we create an environment in which our suppliers feel comfortable collaborating on industry-wide initiatives to boost productivity—such as which key technologies they're adopting, how they're boosting production efficiency, and how they're working with their various retailer clients?
- How can we measure and track the value of each project launched through our SPC?

A look back at how the US apparel supply chain has evolved in the past 50 or so years shows clearly that what was once a domestic industry now counts among the most global—and complex—industries in the world. It's true that the evolution of the apparel supply chain has helped corral production costs, but coordinating and managing all of the different links in that chain have become more and more challenging activities than they ever used to be. And in today's competitive arena, in which the delivery of speed and efficiency in manufacturing has become a mere table stake, US retailers that can deftly manage global supply chains will hold the winning hands. Sure, technological advances are helping retailers surmount the challenges they confront—to some degree. But to pull ahead of rivals—and stay ahead—companies have to start treating their key suppliers as extensions of their own organizations. **A**

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ABOUT US

For nearly forty years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.