



**The New Retail:
Driving Growth through Product
and Supplier Innovation**

White Paper
Prepared by Industry Directions
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Executive Summary

The agenda is shifting for retailers. Severe cost-cutting programs of the past decade are giving way to more strategic private label programs focused on delivering differentiated products with higher margins to the market. Sustainable competitive advantage will belong to those retailers that are able to leverage the expertise of their buying and merchandising teams to innovate new products and markets collaboratively with strategic suppliers.

Driving revenue growth through private label programs will require new cross-organizational processes, technology-enabled collaboration and the ability to proactively manage a multitude of tasks and activities across the business. As new products and suppliers are added to the retailer's portfolio, many require unique processes to support the various phases of sourcing, including trend and concept, product design, specification, supplier selection, production, delivery, consumption and, as appropriate, ongoing customer support. As each new process is implemented, it must support corporate responsibility program guidelines and evolving regulatory requirements.

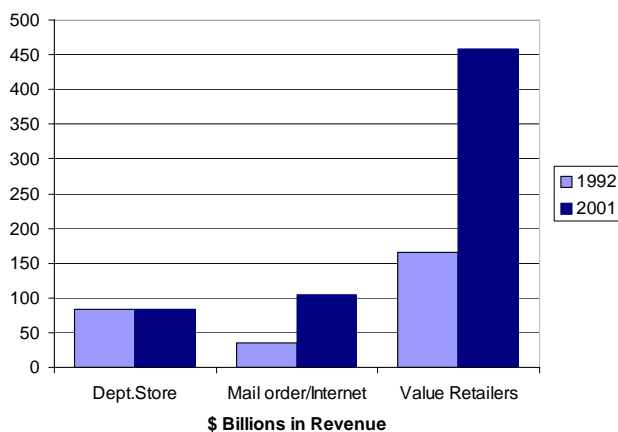
This increasing focus on product innovation is dramatically raising the stakes for the sourcing professional. He or she is accountable for ensuring that information flows spanning sourcing offices, agents, suppliers and regulatory agencies are proactive, synchronized and transparent to the appropriate stakeholders.

Building and managing collaborative processes that span the retail supply chain will not be achieved with manual processes, Excel spreadsheets and legacy systems. Successfully managing these extended activities requires a mission-critical technology platform, a unified database, an integrated supplier network and the ability to proactively manage critical-path processes.

The bar has again been raised for retailers. Knowing that innovation is required is not enough. The new leaders will build a foundation that provides a renewable flow of information to drive growth through product and supplier innovation.

Retail: An Industry Under Pressure

For better or worse, globalization has fundamentally changed retail. The wide availability of low-cost products presents challenges for maintaining both top-line and bottom-line performance. Retail customers have come to expect that they can have their cake and eat it too, meaning that they can choose from a wider array of product offerings and pay a very low price for these goods. For retailers, this expectation has placed tremendous pressure on reducing the cost of goods sold (COGS) at the expense of the value that is ultimately delivered to the consumer.



Source: McKinsey & Co., 2002

Figure 1: Value retailer growth has tripled in the last decade.

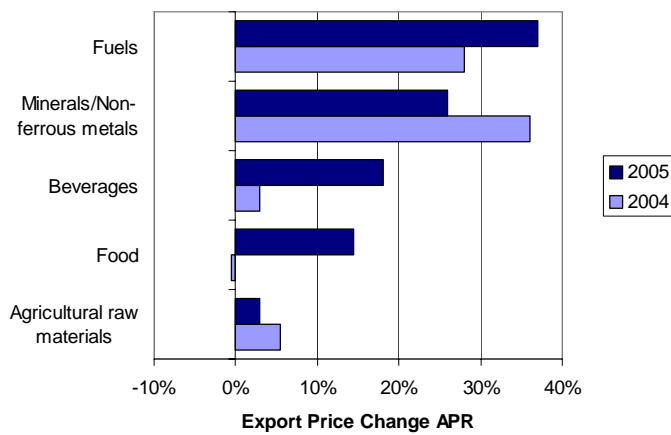
The focus on COGS initially fueled the drive toward global sourcing. Low-cost product demand has been satisfied by using geographically dispersed suppliers supported by low-cost labor. While this trend began tentatively decades ago in the shoe and apparel industries, the mega-retailers were able to scale these capabilities, dramatically growing their businesses and more than doubling their collective market share during the '90s (see Figure 1).

However, despite the phenomenal growth of the mega-retailer approach, a large swath of the market remains committed to traditionally branded products. Smart retailers today are using private label strategies to build their own brand loyalties, while at the same time maintaining or improving profit margins. To do this, they will have to navigate a number of market challenges and opportunities:

- **Low cost:** As retailers have figured out how to bring low-cost goods to market, a sizable part of the market has come to expect and depend on it. Mega-retailers like Wal-Mart have succeeded in part by using the buying power of almost 200 million customers in thousands of stores in over 15 countries to negotiate prices with suppliers. The low-cost market might be crowded, but the impact of mega-retailers has forever changed the game for retailers, suppliers and consumers. It also provides a wide-open field for those retailers that can compete on an aspect other than cost. For instance,

Tesco has improved its responsiveness by using sourcing technology to cut lead times, allowing it to order earlier or delay buying decisions to better reflect changes in consumer buying patterns.

- Private label:** Customers are snapping up private label brands (or store brands) like Sainsbury’s ‘Taste the Difference’ coffee or Wal-Mart’s ‘Old Roy’ dog food in place of national brand products. Industry estimates indicate that about half of all grocery sales in the UK are private label. In the U.S., store brands now hold about a 20% market share in supermarkets and drug chains, and they are expected to grow at a 5% to 6% annual growth rate, according to the Private Label Manufacturers Association. However, the next iteration of this trend is empowering retailers to use massive consumer power to provide high-value goods at reasonable – rather than low-cost – prices. For instance, Best Buy is building its private label strategy by collaboratively building a superior portfolio of flat screen TVs and delivering them at lower prices than the competition.
- New product trends:** Retailers can no longer be confident that last year’s blockbuster product will provide sustainable revenue this year. New products are being introduced into the market at a record rate, and in a demand-driven world, the customer calls the shots. This trend has become increasingly apparent as consumers choose to personalize what were just recently standard products, such as custom-embroidered Nike shoes. Edcon, Southern Africa’s leading retailer, has invested in sourcing solutions that enable it to rapidly deliver apparel “from the catwalk to the store.”
- Price squeeze:** Retailers are feeling pressure not just from consumers pushing prices down but also from suppliers pushing prices up (see Figure 2).



Increasing energy costs are now finding their way into total product costs, whether from material processing, manufacturing or the physical movement of product to market. In fact, recent research from Industry Directions shows that five times as many retail and consumer goods companies anticipate that increased energy costs will erode their margins; this is compared with the same time

Source: IMF, International Financial Statistics, 2006

Figure 2: Suppliers feel pressure from high material costs.

last year when gas prices were essentially the same. This research reflects the reality that consumers simply refuse to have these costs passed on to them if they can help it. Fuel is not the only cost that retailers have to absorb: Minerals and metal costs remain high, and the cost of coffee beans and teas, key to beverages, have skyrocketed.

- **Globalization:** Many retailers hope they can ride the globalization wave and penetrate the very markets from which the cost erosion stems. Hundreds of millions of new consumers will likely emerge from countries like China, Malaysia, Singapore, Taiwan and India over the next decade. However, gaining a foothold in these markets is more involved, expensive and time-consuming than most companies had imagined.
- **Dynamic market demand:** Another revenue opportunity for retailers is to drive more cycle turns, or seasons, and in some instances creating interim-season options. While product testing requires local investment, it is exponentially more costly to miss the market after driving a product through production and into the channel. One too many market misses or slow introductions in one year could put a retailer out of business. Successfully increasing the number of cycles implies that the retailer is anticipating seasonal demand and other market changes – often before they occur. Determining market demand is often as much art as science. Global sourcing may have extended supplier reach, but it has also stretched lead times, forcing buyers to make calls on products earlier than usual. Unforeseen market shifts that occur during the wait often result in markdowns and clearance.

In the future, successful retailers will find that traditional sourcing processes and disparate technology systems will be insufficient to support the collaboration required to drive innovative and differentiated products into global markets.

Global Sourcing and Supplier Management

It is one thing to talk innovation and quite another to do it right. Traditional sourcing and purchasing efforts have consisted of simplistic communications between the retailer and its suppliers. Innovating new products and developing new markets requires gathering critical information and developing synergies across the supply chain – beginning with consumers that are driving demand through collaborative planning processes and, ultimately, to a supplier base eager to help satisfy and anticipate current and future demands.

Aggressive global sourcing programs are forcing retailers to become increasingly dependent on geographically remote suppliers, many of which will not be personally vetted. If the retailer does not have a local sourcing office or the internal expertise to manage offshore suppliers, it often relies on full-service agents to act as intermediaries. However, this approach generally results in both smaller margins for the retailer and an additional link in the chain where the retailer does not have visibility or control.

Delegating tasks and responsibilities to agents and suppliers does not indemnify the retailer from accountability. In fact, seeking out new sources of supply can introduce previously unknown risks such as safety and security, as well as strain the company’s ability to meet regulatory guidelines, ranging from ethical labor rules to Sarbanes-Oxley financial standards. It is up to the retailer to implement holistic processes, enforce best practices and ensure full transparency, thereby minimizing risk.

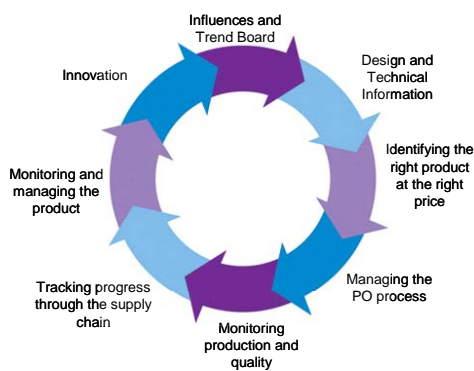


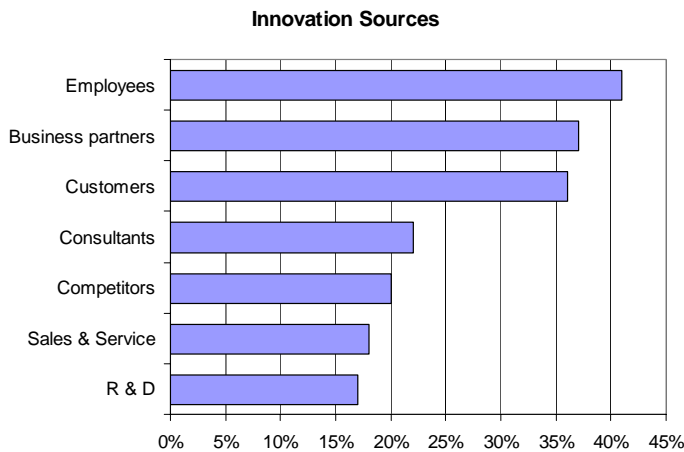
Figure 3: Innovation in retail calls for cross-enterprise business process alignment.

Leading retailers are adopting global sourcing and supplier management as a corporate-wide, inter-enterprise strategy to grow revenues and pursue new market opportunities. Forward-thinking companies are enabling processes with technology that supports the product lifecycle – from product concept, through global sourcing, to logistics and delivery to the importer (see Figure 3):

- New Product Development:*** Innovative new products often begin as concepts that emanate from merchandising and other areas of the business. But before concepts can become products, additional intelligence and collaboration is required from a number of venues, including consumer trends, fashion shows and the competition. It is not uncommon for retailers to rely on the generation and tracking of thousands of spreadsheets among stakeholders to fully develop a targeted product concept. Technology-savvy companies are building design briefing work flow processes that drive a broader collaboration process, thus enabling a faster and more accurate description of product and packaging, technical requirements and commercial objectives. Moving from product concept through market delivery should encourage the creative and collective energy of individuals and organizations, many of whom are often beyond the retail enterprise.

- **Supplier Selection:** There are numerous retailer-supplier relationships that range from long-term contract manufacturing, to issuing requests for quotation (RFQs) to known suppliers, through "inviting" previously unknown suppliers to register for future bid consideration. Regardless of the type of relationship, sourcing and procurement professionals are responsible for understanding production capabilities, the availability of raw materials and the supplier's ability to deliver quality product within the specified timeframe and cost structure. Other important sub-processes can be overlooked, such as monitoring ongoing quality testing, meeting all industry regulations and ensuring that factory audits and compliance action items are completed in a timely fashion.
- **Order Tracking and Logistics:** Once the supplier is selected, product specifications and manufacturing plans are shared. Key production phases should be tracked to affirm product test results and factory compliance. Upon final product inspection and release from the factory, shipments are tracked throughout various stages of the supply chain, from country of origin, through export customs, in transit, and into the importing country. The ability to proactively manage the sourcing process based on milestones that include product design, critical stages of manufacturing and important steps through international trade and transportation are critical in terms of a retailer's ability to manage and control this portion of the business.
- **Supplier Management:** Negotiating contracts and managing day-to-day transactions fall under the guise of supplier management. However, for retailers pursuing private label strategies and other innovative programs, honing the ability to work collaboratively and synergistically with strategic suppliers is critical to future success. Leading retailers have stratified vendor relationships – from most to least strategic – and are defining best practices for managing each level. It is not uncommon for today's larger retailer to have several thousand suppliers and to manage ongoing communications with tens of thousands of spreadsheets. Looking forward, collaborative technology platforms will change the way that supplier relationships are managed.

This broad-based approach to global sourcing and supplier management stands in stark contrast with supplier-driven approaches from a decade ago. Not only have many of the former communications become collaborative, but events are also no longer static and contained within a uni-directional chain. The "chain" is now a circle (see Figure 3), supporting any number of parallel and synergistic processes, subject to frequent changes, simultaneously driving innovation.



Source: The Global CEO Study 2006, IBM

Figure 4: Increasingly, companies are looking outside of their enterprises for additional sources of creativity to help them drive innovation within.

Clearly, the role of the sourcing executive is evolving, as well. Today’s responsibilities have expanded well beyond best-cost negotiations to include managing collaborative sourcing processes that span from product concept on one side, to product delivery on the other. In effect, sourcing executives and buyers now manage multiple product portfolios, each with unique business processes, product

lifecycles and ecosystems of sourcing offices, agents and suppliers. Like any smart portfolio manager, buyers need to proactively and simultaneously monitor key factors relative to performance, visibility and financial control.

The role of the supplier has also changed. Once merely the low-cost producer of commodity products, strategic suppliers now function as critical partners that work with their retail partners to identify opportunities to leverage existing designs and components, rather than starting from scratch. Or it can mean working from existing manufacturing lines and coordinating with logistics to determine the optimal packaging, containers and routes for lowest-cost shipment. Finally, strategic suppliers are adding value by introducing new product capabilities for retailers to consider. Forward-thinking suppliers have reinvented their roles as vital participants in the retail product lifecycle, thereby becoming strategic partners to the retailer (see Figure 4).

Delivering Short-Term Tangible Results

A successful global sourcing and supplier management program should be designed and equipped to harness the talent of buying teams, leverage strategic supplier expertise and create a collaborative culture that delivers bottom-line results that typically include:

- **Improved revenue:** Moving product more quickly and frequently will translate into faster cycle turns for consumers and improved cash-to-cash cycles for the company. Retailers that can bring more of the right products

to market faster than their competition not only increase revenue but also gain competitive advantage.

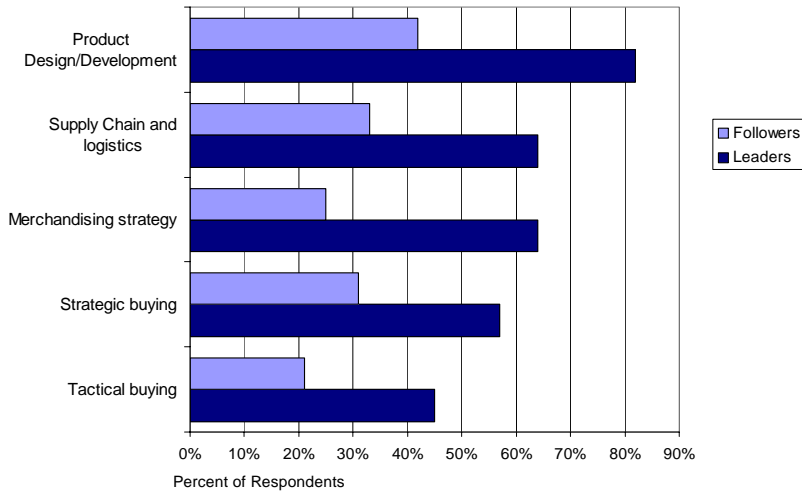
- **Reduced stock-outs:** Retailers can reduce stock-outs by buffering inventory, developing more precise forecasts or by receiving frequent demand updates from the stores and posting updated forecasts for suppliers. Global sourcing programs facilitate these processes by providing the infrastructure required to better balance supply and demand. Industry data indicates that well-run sourcing strategies have been proven to reduce cycle times by 30% and reduce cost of goods sold.
- **Product differentiation.** Bain & Co. points to an “innovation fulcrum,” where associated product costs outstrip additional revenue. Instead, companies should focus on revenue-enhancing innovations, like repackaging existing aspirin to be sold for travel or convenience rather than developing a new form of aspirin. Innovative sourcing programs enable all stakeholders – both internal and external – to participate in total product concept analysis, helping to determine which new products should be added to the product portfolio.
- **Private labeling.** As consumers increasingly see private label brands as having essentially the same value as national brands, many large retailers are enjoying margins exceeding 35% from private label products. By leveraging ecosystem partners, even smaller retailers can succeed by achieving holistic process control over the product lifecycle.
- **Fast fashion.** Fast fashion, or speed sourcing, has been associated with some remarkable concept-to-store-shelf success stories of European apparel retailers. However, similar capabilities can be used to bring other consumer goods to market more quickly. Fast fashion involves a number of different facets, but it is driven by three primary ones: use existing product materials or components rather than having to invent new ones; begin production as soon as possible; and make final design decisions as late as possible, based on the latest input from the field. Fast fashion is not applicable to every product, but in hypercompetitive markets, it can be used to provide significant time-to-market advantage, provided the retailer can coordinate stakeholders quickly enough.

The implementation of a global sourcing and supplier management program will help to deliver results such as these. However, new technologies must be adopted to sustain competitive advantage and to promote innovation.

Harnessing Technology to Drive Innovation

While driving growth through innovation may be a call-to-action for the retail industry, the reality is that the majority still use telephone calls, Excel spreadsheets and flat file transfers as preferred methods of communication. Collectively, these do not enable either a single version of the truth nor visibility across the enterprise, let alone the retail supply chain.

According to A.T. Kearney, those retailers that are leading in revenue and profitability are also taking advantage of proactive collaboration techniques to share information and metrics in a number of key areas (see Figure 5). In a



Source: A.T. Kearney "Making Procurement a Priority" 2004

Figure 5: Leaders proactively collaborate with their key suppliers.

nutshell, leaders are leveraging technology to support current processes. It is not a coincidence that Wal-Mart, the most successful retailer in history, is also renowned for extending its technology systems to suppliers and other partners throughout its supply chain. Nor is

it coincidence that Dell Computer, the only remaining PC giant, built the foundation for its success by developing an unparalleled global supply network management strategy.

For retailers hoping to exploit the opportunities associated with private labeling, direct sourcing, fast fashion and global sourcing, revamped processes and technology systems that enable collaboration and innovation are prerequisite enablers. Retailers must consider the following functional requirements:

- Product Lifecycle Management (PLM):** Once mainly associated with discrete manufacturing, PLM is now a fast-emerging staple of retail and consumer goods. The reasoning is simple: retailers either sell or intend to sell private label products that require conceptual planning, product design,

testing, material and component re-use. Further, every product has a lifecycle that must be effectively planned and managed. It is clear that sourcing, production, sales and after-market activities are a part of the product conception-through-delivery lifecycle. For retail, PLM capabilities must support trend and concept development, product design, design briefs, testing, sampling and production, as well as product packaging and technical requirements. Retail PLM should also include an historical product information system to ensure that designers are leveraging prior experience regarding previous product launches.

- **Sourcing:** For the modern retailer, the goal of sourcing is to identify, qualify and manage the ongoing relationships between suppliers and the company. Managing supplier performance will include collaboration across multiple functions, including product design, finance, procurement, production and logistics. Further, the role of sourcing goes deeper, as it now takes on the responsibility of quality and risk management by ensuring that suppliers meet socio-ethical requirements, deliver compliant goods to the consumer and provide a single version of the truth to all parties.
- **Production & Logistics:** For retailers, chances are fairly high that both production and logistics will be largely or entirely outsourced. On the production side, it is imperative that the solution would be able to access data regarding test runs, production runs and ongoing health and safety of factories. The majority of retailers work with third party logistics providers (3PLs) that manage packing and shipping containers, coordinate the movement of goods across modes of transportation and ultimately track the movements of goods through ports, customs and distribution centers.
- **Demand Management:** In modern retail, “best-guess” forecasting is generally unreliable, and point-of-sale information is often unavailable, making it difficult to respond to or drive demand quickly enough. The ability to manage demand includes not only closely tracking product performance by store, distribution center and supplier, but also integrating this information into customer service, reverse logistics and customer relationship management systems to determine why and to what degree a product is succeeding or failing in the market. Demand data is essential to completing and renewing the product lifecycle. In today’s world, both anticipating and driving demand are critical success factors.

Limiting the solution decision to functionality alone could be a costly mistake. Technology requirements for global sourcing and supplier management may be best served with solutions developed on a services-oriented architecture (SOA).

SOA-based solutions enable buyers and sourcing professionals to design and implement cross-enterprise business processes that support specific sourcing and supplier management requirements. Solutions designed to leverage SOA should provide the following:

- **Accessibility:** Global sourcing and supplier management solutions must be accessible via the Internet, either in a hosted environment or within the retailer's firewall. Either way, users – inside and outside the enterprise – should be able to gain access to application functionality and information that spans the enterprise and the supplier community by simply using their Web browsers.
- **Application interoperability and connectivity:** Leveraging SOA capabilities should ensure the synchronization of processes that span the enterprise and the supplier community on a real-time basis. Leveraging web services will enable applications to exchange data in real-time between legacy enterprise and supplier systems. Additionally, SOA-based solutions facilitate the registration and rapid on-boarding of new suppliers, sourcing offices, agents and other trading partners.
- **Business process modeling:** Each retailer has unique and explicit process requirements – for example, fashion retailers are very different from frozen food retailers. Further, in today's dynamic market environment, merchandisers and sourcing professionals must be able to reconfigure business process flows quickly and often. This underscores the need for easy-to-use visual authoring tools that enable the rapid development and implementation of process models that illustrate functional flows, describe business rules and track the flow of information.
- **Milestone tracking:** Sourcing and supply chain professionals must have the tools that enable them to establish critical path milestones based on historical performance and future estimates – and then monitor progress over time. They should receive alerts for any number of reasons, such as production delays, port strikes and customs delays, facilitating more informed and rapid decision making.
- **Supplier portals:** The supplier portal is an important tool for offshore factories and plants serving retailers. In addition to providing views into retailer plans, these portals manage the exchange information in a secured and controlled environment, as well as enabling retailer negotiations and collaboration.

- **Dashboards:** A vast increase in operational data requires a robust data collection strategy, the ability to rationalize and standardize results and the delivery of relevant information to professionals via Web-based dashboards. Sourcing solutions built on a services-oriented architecture facilitate the integration of pertinent information from across the enterprise and supplier network, and they can ultimately deliver the appropriate level of information via the Web. Uniquely configured dashboards should enable buyers to visually comprehend the overall well-being of their product portfolios in a timely manner. For instance, a dashboard might illustrate the design progress of next season's products, show progress relative to established critical path milestones and deliver real-time alerts on underperforming suppliers.

Supporting Product and Supplier Innovation with Eqos

Most retailers today are not eager to update their technology solely for the sake of an improved infrastructure. IT resources are expensive and often dedicated to long-term projects, such as maintaining or harvesting capabilities in existing systems. Nor are retailers keen to divert funds from promotion projects, as they feel margin pressure from customers who want lower price products and suppliers whose costs are only increasing. So, retailers are not going to invest in technology unless they must and unless they are certain that the investment will reap rewards.

It is difficult to decide not only what applications to deploy but also when to deploy them. While investments in ERP (enterprise resource planning) and point solutions have paid off for many companies, those returns took time and patience, and the question of whether the investment would ever pay out lurked over executive management like a shadow. However, for retailers that hope to thrive in today's global consumer markets, there isn't much choice: They must evolve to survive.

Eqos has heeded the realities that retailers face today and into the future. The company was founded in 1997 as a B2B collaboration platform company supporting Sainsbury's (a leading grocery chain in the UK) supplier network. Today, its solutions support supplier management and sourcing processes for customers such as Tesco and Best Buy, enabling them to significantly grow their private label businesses.

Eqos solutions largely meet the sourcing and supplier management technology requirements defined in this paper. Its solutions reflect deep industry expertise

gained from working with these customers, beginning with enabling the product concept and specification phases, supporting factory audits and meeting regulatory compliance requirements, while analyzing the performance of the global supplier network. To wit, Eqos currently has over 5,000 suppliers directly integrated into and using its next-generation sourcing solution.

Eqos solutions were built from the ground up on a services-oriented architecture. Its solutions not only support the most complex retailer and supplier networks, but they also enable retailers to configure and reconfigure unique business processes without continuous IT assistance. The majority of its customers have opted for Eqos to support their IT operations via a hosted computing environment.

Conclusion

Competing through innovation in retail is not a simple undertaking. Becoming truly innovative calls for more than just delivering new products. Retailers must gain visibility into new ideas and critical information that enables them to leverage concepts into products – and then bring them to market quickly, efficiently and by coordinating efforts across their organizations and across the supplier network.

Innovation is a team sport, and it requires the coordination of all players operating at peak performance and working toward the same objective. It calls for retailers to critically assess their operations and supporting processes – not only internally, but also those that they share with their trading partners.

Finally, innovation calls for a technology framework to support these operations and synchronize processes. Retailers, agents and suppliers need visibility into one another's activities, and they must be able to share critical information in a timely and appropriate manner. Further, sourcing executives require more control over supplier processes and less dependency on IT. This requires a flexible solution architecture that enables process mapping, the rapid on-boarding of new suppliers, systems interoperability and business analytics.

Clearly, the road to becoming an innovation-driven retailer is not a short or simple one. However, it is certainly possible. The adoption of the new generation of sourcing application functionality and technology will allow retailers to approach the market with an entirely new perspective that leverages the collective creativity and power of the ecosystem to gain meaningful competitive advantage.



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William Brandel conducts analysis and assessment of software and business practices that are used to provide effective enablement, alignment, visibility, collaboration and optimization of supply chain processes in enterprises and trading networks. Prior to joining Industry Directions, Brandel researched the supply chain management market for Aberdeen Group, where he focused on collaboration and developed the Business Process Network process and application interaction framework. Prior to becoming an analyst, Brandel garnered hands-on business and technology experience by directing and driving the operations of a number of Internet-enabled business initiatives focused on procurement, supplier management and online content. He has over 10 years of business and technology editorial experience and has won awards for his reporting and online content efforts.

About Industry Directions

Industry Directions is an industry analyst firm that conducts research on the business processes and enabling technologies used in manufacturing value networks in specific vertical industries. These industries include every type of manufacturing, from pure process industries such as oil and gas, to batch process such as food and pharmaceuticals, to discrete such as automotive, electronics and aerospace, to mixed-mode industries such as consumer durables. Areas of focus include supply chain, business-to-business, production, lean and other improvement initiatives, enterprise management, product lifecycle management and performance management. To learn more, visit www.industrydirections.com.

About Eqos

Eqos is a leading provider of global sourcing and supplier management solutions for the retail supply chain. Founded in 1997, Eqos has offices in Boston, U.S., and London, UK. Eqos' solutions streamline processes from product concept through product development, buying, manufacturing and delivery to the retailer. Eqos' solutions are built on an award-winning collaboration platform that enables the rapid configuration of processes between retailers and their suppliers, buying offices and other trading partners. Leading retailers such as Best Buy, Debenhams, Sainsbury's, Tesco and Virgin MegaStores are among Eqos' customers. More information can be found at www.eqos.com.

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