Article

Convenience Store Blues - the Cost to Serve challenge

Craig Ryder and Gavin Parnell, directors at Go Supply Chain Consulting, outline the challenges to multiple grocery retailers of expanding into the convenience space.

A sea change in consumer buying habits is reshaping the grocery and food sector – and this demands an examination of logistics cost to serve models. Of the £177.5bn spent in the sector during 2015 more than 50% was with the majors, according to sector researcher IGD. However there is a shift towards convenience stores, smaller supermarkets and particularly to the discounters.

Already the second largest grocery channel, according to IGD, the convenience sector continues to grow and will account for nearly a quarter (24%) of food and grocery sales by 2019. Convenience stores (c-stores) such as SPAR, the Co-operative Group and Londis are open for long hours and sell products from at least seven grocery categories. Their largest expenses are labour and inventory. Faster turnover is also a big focus, especially on perishable goods.

C-stores are typically much more expensive to serve as a percentage of sales than the traditional big stores. As a result, customers pay for the convenience. This sector is struggling with the global growth of the discount food stores, which are encroaching on their space.

The no-frills discounters – such as Aldi, Lidl and Netto – are increasingly popular thanks to their small format, low cost, acceptable quality offers. Their share of the market, currently just under 10%, is projected to double in value over the next four years.

What then can the major supermarkets learn from c-store operators and discounters as they continue to expand into the convenience arena? Efficiency in every area of their distribution operations will be key – they need to offer maximum value at minimum cost to meet customers' expectations. Areas of focus will include implementing leading warehousing technologies and automating facilities both there and in-store.

Modelling the cost to serve

Transport costs must also be addressed. They are relatively high for small supermarkets, particularly if retailers insist on daily fresh deliveries in the morning across the estate. The Transport 'cost to serve' can vary enormously as a percentage of sales revenue according to store format / sales mix, geographical location, clustering, vehicle types, delivery timings, delivery frequency and a host of other factors.

However, cost to serve modelling will reveal the truth behind the aggregated numbers that appear in accounts – and allow the running of scenarios around some of the variables mentioned above.

Cost to serve is about understanding the logistics cost to serve at the level of customer / product interactions. This also works well for retailers by substituting the word 'store' for 'customer'.

Businesses usually have an overall understanding of logistics costs but are often unable to express these for a particular customer, product, or group of customers / products. When they do, businesses can optimise profitability by effective targeting of cost reduction initiatives, renegotiation of commercial terms and route to market changes.

Commonly used metrics, such as logistics cost per unit or cost as a percentage of sales, do not differentiate adequately between customers / products. The cost to serve analysis, however, will show the logistics cost behind serving each customer and product. This reveals the hidden profits and hidden losses behind the overall profit.

Major supermarket reduces capital expenditure
A major supermarket chain, with sales exceeding £20bn annually, engaged us to review expansion plans for its distribution network, designed to accommodate business growth amid the shifting trends in the grocery market that we have discussed.

We modelled logistics costs from the supplier through to store, on a product-by-product basis. This model examined a number of stocking options for each product such as stockless, holding the product regionally or holding it nationally. In each case the most cost effective option was identified.

This helped to define the future requirements for the distribution network, by determining the storage and throughput requirements for regional and national DCs.

With the help of further modelling, we examined the preferred shape of the future distribution network, defining the optimal number, location and function of DCs. Working closely with stakeholders we built a 'road map', taking into account commitments to existing facilities.

The revised plan contained fewer additional DCs and increased DC utilisation (annual cases shipped / square feet). As a result there was a significant reduction in planned capital expenditure.

Also consider
Multiple retailers will also need to consider adopting some of the tactics of the discounters, such as:

- Limiting their number of product lines and thereby reducing the number of suppliers and number and frequency of deliveries
- Displaying their goods in open cartons or stacked on pallets. The discounters don't charge suppliers for shelf space
- Reducing staff to the minimum to satisfy customers but paying them better
- Cutting out extensive loyalty schemes and reducing expensive advertising and promotions. In particular, traditional multi-buy promotions don't lend themselves to smaller formats where shoppers are not in 'stocking up' mode

The whole industry continues to work to drive down inventory levels in the supply chain. This can mean owning stock for as little as 24 hours before it is moved to store, and for suppliers it means becoming more responsive and being able to meet shorter lead times.
In the short-term, the majority of food and groceries will still be bought in hypermarkets and super stores. They will continue to represent over a third of the total grocery market but the trend will be towards them increasingly being used as pick-up points for click-and-collect orders and to service online home delivery orders.

Go Supply Chain has produced tailored cost to serve models for customers in retail, food and non-food manufacturing. The models are well structured and we work closely with your team in development and handover. To find out more email info@gosupplychain.com or call 01753 722060.

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Editor Notes

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Founded by an experienced and capable team of logistics consultants, Go Supply Chain combines practicality with a highly analytical approach, reflecting its blend of operational and consulting experience.
Clients range from global corporations to fast-growing, entrepreneurial companies. Go Supply Chain works both in the UK and internationally – the team has completed projects in 16 countries.