SUPPLY CHAIN COLLABORATION is a hot topic today—and no wonder: companies that collaborate effectively across the supply chain have enjoyed dramatic reductions in inventories and costs, together with improvements in speed, service levels, and customer satisfaction.

Collaboration between companies—joint initiatives that go beyond their normal course of day-to-day business, with the aim of delivering significant improvement over the long term—is particularly attractive for the consumer packaged goods (CPG) sector. With pricing under pressure from recession-scarred consumers, the temptation for retailers is to transfer the pain upstream to their suppliers by passing on price reductions and forcing them to bear an increasing share of costs. On the supply side, however, there is less and less room for manufacturers to absorb additional costs as volatile input prices put the squeeze on margins and the marketing investment required to differentiate branded products from private-label competitors continues to rise.

CPG players are looking at collaboration initiatives as a way out of the damaging spiral of antagonistic relationships. That’s one reason why collaboration efforts between manufacturers and their retailer customers have dramatically grown in popularity in recent years. That was clearly evidenced in the 2008 annual Customer and Channel Management (CCM) Survey, conducted by McKinsey & Company, Nielsen, and the Grocery Manufacturers Association, when chief executive officers in the CPG industry identified collaboration with partners as their highest strategic priority. In the 2010 edition of the same survey, more than 80 percent of the companies surveyed said they were involved in at least one collaboration initiative, and some were involved in as many as 10 such arrangements.

Supply chain collaboration has delivered some real value for participants, but overall, these initiatives are more likely to fail than to succeed. Indeed, participants in the 2010 CCM survey said that only two in 10 of their collaboration efforts delivered significant results. The remaining 80 percent represent more than just lost opportunities to add value. If companies can’t make collaborations work, they will not only fail to achieve the potential benefits that supply chain collaboration can provide, but they will also risk destroying
the enthusiasm for failure attempts, both inside their own organizations and with their trading partners. The high rate of failure among today’s collaborations is not inevitable, however. There are several ways CPG manufacturers and retailers can avoid some of the common pitfalls and achieve the benefits they seek. This article will first consider some of the conditions and practices that prevent effective collaborations, and then look at actions manufacturers and retailer partners can take to ensure success.

Why collaboration is hard

In our work helping retailers and CPG manufacturers manage their collaboration efforts, we have seen a handful of factors that make collaboration problematic. Some of these will be familiar to any organization that’s involved in a large-scale change process. Companies may, for example, lack the commitment that is necessary to bring about the change. Or the message that the collaboration is important may be “lost in translation” as it passes down through the organization, with the result that middle managers or front-line teams don’t show the same enthusiasm and commitment as their leadership does. Sometimes companies fail to provide sufficient resources to make collaborations work, or they spread limited resources too thinly over too many initiatives. These issues are difficult enough to overcome, but they are compounded by the fact that collaboration involves the ability to best align two separate organizations. To make the collaborations work, the players involved must navigate differences in organizational design and culture. Over time, a history of difficult relationships can make partners reluctant to share important information, leading them to work on their parts of the relationship “in separate silos”—a recipe for suboptimal solutions.

Finally, the incentives of the different parties involved in the collaboration may be fundamentally misaligned, making it difficult even for enthusiastic committed staff to make the collaboration work while still fulfilling their other tasks. These misaligned incentives make it more difficult to motivate everyone in the supply chain to see the world in very different ways. A manufacturer, for instance, might want to grow its business by cutting out the manufacturer’s distribution centers and eliminate the “collaboration” in separate silos—a recipe for a frustrating one.

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Collaborative efforts failed to play to either company’s strengths, however. The retailer’s rich consumer data was wasted, while the manufacturer’s category management skills were misaligned. There was no clear understanding of the information needed to develop an accurate profile of its customers’ requirements, but concerns about sharing that information led the retailer to analyze the data and develop the product specification itself without the benefit of the manufacturer’s category expertise. The resulting product was expensive to make and missed the mark on package size, product specifications, and shelf appeal. Sales were disappointing, and within months the partners were forced to reasse the relationship.

Making the right choices

Consumer packaged goods companies can greatly increase their chances of success by taking a thoughtful approach to the areas they select for collaboration, their choice of partners, and the way they implement their collaborations. Based on our experience, we have identified six essential steps (summarized in Figure 1) that can make the difference between a productive collaboration and a frustrating one.

1. Collaborate in areas where you have a solid footing. Companies are often tempted to use collaboration as a way to fill gaps in their own capabilities, but the map the most successful collaborations build on strengths rather than compensating for weaknesses. A manufacturer seeking to collaborate with a major retailer in order to improve its forecasting performance, for example, will have little to gain from access to the retailer’s point-of-sale data unless it has the in-house analytical capability to make effective use of that data. Similarly, there is little point in entering collaborations to boost sales if any increase in demand is likely to run into manufacturing-capacity constraints.

In advance of any collaborative effort, is top management committed to the collaboration process and ready to offer support over the long term? Are incentives and resource commitments sufficient to make the collaboration work, or could they be reallocated to other priorities? Second, do both partners have sufficiently strong commitment and motivation to make the collaboration work? Third, is there enough potential value in collaborating withthis partner to merit the effort? Both partners in a prospective collaboration need to be sure that it will deliver a sufficient return to justify the upfront investment. Second, both parties to a collaboration need to have the same basic strategic interests to support the collaboration. A retail partner that has prioritized growth in a particular region or segment will have more to gain from managing a collaborative partnership than a large chain focused on its core offering in the same area. Third, does the partner have the right infrastructure and processes in place to provide a basis for the collaboration? A fourth step is to improve forecasting and demand planning is likely to be frustrating if one partner’s existing planning processes, systems, or performance are inadequate.

2. Turn win-lose situations into win-win opportunities with the right benefit-sharing model. Some collaborations promise equal benefits for both partners, but turn into money-losing propositions. It’s far better to assess current customers or suppliers across three key dimensions. First, is there enough potential value in collaboration withthe other company to merit the effort? Both partners in a prospective collaboration need to be sure that it will deliver a sufficient return to justify the upfront investment. Second, both parties to a collaboration need to have the same basic strategic interests to support the collaboration. A retail partner that has prioritized growth in a particular region or segment will have more to gain from managing a collaborative partnership than a large chain focused on its core offering in the same area. Third, does the partner have the right infrastructure and processes in place to provide a basis for the collaboration? A fourth step is to improve forecasting and demand planning is likely to be frustrating if one partner’s existing planning processes, systems, or performance are inadequate.

3. Select partners based on capability, strategic goals, and value potential. The biggest potential partner might not be the best one. Many companies aim to collaborate with their largest suppliers or customers because they assume that the greatest value is to be found there. In many cases, however, this turns out not to be true. Collaboration may be of more interest to a smaller partner, which might invest more time and effort in the program than a very large one that is already juggling dozens of similar initiatives. A better approach is one that assess current customers or suppliers across three key dimensions. First, is there enough potential value in collaboration withthis partner to merit the effort? Both partners in a prospective collaboration need to be sure that it will deliver a sufficient return to justify the upfront investment. Second, both parties to a collaboration need to have the same basic strategic interests to support the collaboration. A retail partner that has prioritized growth in a particular region or segment will have more to gain from managing a collaborative partnership than a large chain focused on its core offering in the same area. Third, does the partner have the right infrastructure and processes in place to provide a basis for the collaboration? A fourth step is to improve forecasting and demand planning is likely to be frustrating if one partner’s existing planning processes, systems, or performance are inadequate.

4. Invest in the right infrastructure and people. Both manufacturers and retailers that participated in our research cited a lack of dedicated resources as one of the top three reasons for the failure of collaboration efforts. Companies frequently underestimate the resources required to make collaborations work, potential that staff that in the effort. Both parties to a collaboration need to have the same basic strategic interests to support the collaboration. A retail partner that has prioritized growth in a particular region or segment will have more to gain from managing a collaborative partnership than a large chain focused on its core offering in the same area. Third, does the partner have the right infrastructure and processes in place to provide a basis for the collaboration? A fourth step is to improve forecasting and demand planning is likely to be frustrating if one partner’s existing planning processes, systems, or performance are inadequate.

5. Jointly manage performance and people. Some of the common pitfalls and achieve the benefits they seek.

6. Invest in the right infrastructure and people. Both companies achieved into a joint pool, which would then be invested in efforts to generate additional sales. In other cases, however, the collaboration might create value above the level of the two companies involved, and a retailer chain provides an instructive example of this principle in action. A retailer and a manufacturer were able to achieve as much value overall but the benefit could fall short because they did not think through the consequences of the decisions they made. For example, the retailer believed that sharing that information would be a way to fill gaps in their own capabilities. In practice, however, the resulting product was expensive to make and missed the mark on package size, product specifications, and shelf appeal. Sales were disappointing, and within months the partners were forced to reassess their relationship.

7. Collaborate for the long term. Sometimes companies fail to provide sufficient resources to make collaborations work, or they spread limited resources too thinly over too many initiatives. These issues are difficult enough to overcome, but they are compounded by the fact that collaboration involves the ability to best align two separate organizations. To make the collaborations work, the players involved must navigate differences in organizational design and culture. Over time, a history of difficult relationships can make partners reluctant to share important information, leading them to work on their parts of the relationship “in separate silos”—a recipe for suboptimal solutions.

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In practice, even relatively simple collaborative tasks can be much more difficult than equivalent activities conducted within the walls of the organization. That’s because staff must overcome differences in culture, organization, and terminology, not to mention the basic challenge of finding the right contact within the partner organization with whom to liaise.

Disconnected within one organization can create problems for a successful joint venture. In a collaboration started between two supply chain managers can lead to rapid performance improvements, only to be snuffed out when those higher in the organization fail to understand the initiative’s potential. Alternatively, a collaboration agreement made between two board-level executives will fizzle out if the managers responsible for executing it think it is yet another short-lived senior management whim, if they can’t see how the collaboration will help them achieve their own objectives, or if they lack the incentive to put additional effort into the project on top of their existing day-to-day roles.

To prevent both of these problems, best practice companies devote extra resources to their collaborations, particularly in the early stages of a new relationship. Appropriate infrastructure for a successful joint effort begins at the top of the organization, with a steering committee of senior leaders who can set the defining vision for the collaborative effort and allocate resources to support it. The detailed design of the collaboration program is then completed by a team comprising members of all relevant functions from both partners in the collaboration. The team for a demand-planning effort, for example, should include members from sales, finance, and supply chain, as well as personnel responsible for manufacturing, merchandising, and store operations for the retailer. This team will also be responsible for the day-to-day monitoring of the effort once it is up and running.

Execution of the collaboration should take place within the line organization and will ultimately form part of the everyday responsibility of the staff assigned to it. If the collaboration begins to flounder, the staff to “reinvent the wheel” by providing strong support when establishing the joint effort. They may, for example, leverage experience gained in previous collaborations by briefing up teams to support their colleagues during the initial phase of subsequent efforts.

5. Establish a joint performance-management system. An effective performance-management system helps a company to ensure that any long-term project or venture it starts will last. In supply chain collaboration efforts, both partners should use the same performance-management system. To build common metrics and targets—and jointly monitor progress—companies avoid the misaligned incentives that damage so many collaboration efforts. Picking the right metrics can be challenging, however, and it will inevitably involve trade-offs. In a collaboration to reduce logistics costs, for example, the partners may have to choose between a pallet configuration that’s optimized to suit a retailer’s restocking procedure, which will reduce in-store labor costs, and one that optimizes truck fill, which will reduce transportation costs from distribution center to retail store. How do they resolve these potential conflicts? The key is to think things simple by picking the smallest possible number of metrics required to give a picture of the collaboration’s performance, making sure those metrics closely, with regular joint reviews and problem-solving sessions to address trade-offs. The real power of any performance-management system comes from the conversations between partners, and the experience of working closely together means that joint initiatives will take less time and be easier to execute than early ones.

Potentially huge payback

It should be clear by now that successful supply chain collaboration is neither quick nor simple. But is it worthwhile? The answer has to be an emphatic “yes.” In one experience, successful CPG collaborations that involve two companies in one category delivered a return that’s equivalent to a profit increase from 6 percent to 11 percent in the affected category, through a combination of increased sales and reduced costs. What could that mean for the consumer packaged goods sector as a whole? Our models suggest that if a grocery retailer could collaborate in this way with the top three brands in each of its top 25 grocery categories, it would enjoy benefits equivalent to a 4-percentage-point increase in its EBIT (earnings before net interest and tax) margin. For manufacturers, the same level of collaboration could lead to a 4-percentage-point increase in profit, and one that optimizes truck fill, which will reduce transportation costs from distribution center to retail store. How do they resolve these potential conflicts? The key is to think simple by picking the smallest possible number of metrics required to give a picture of the collaboration’s performance, making sure those metrics closely, with regular joint reviews and problem-solving sessions to address trade-offs. The real power of any performance-management system comes from those metrics required to give a picture of the collaboration’s performance, making sure those metrics closely, with regular joint reviews and problem-solving sessions to address trade-offs. The real power of any performance-management system comes from the conversations between partners, and the experience of working closely together means that joint initiatives will take less time and be easier to execute than early ones.

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