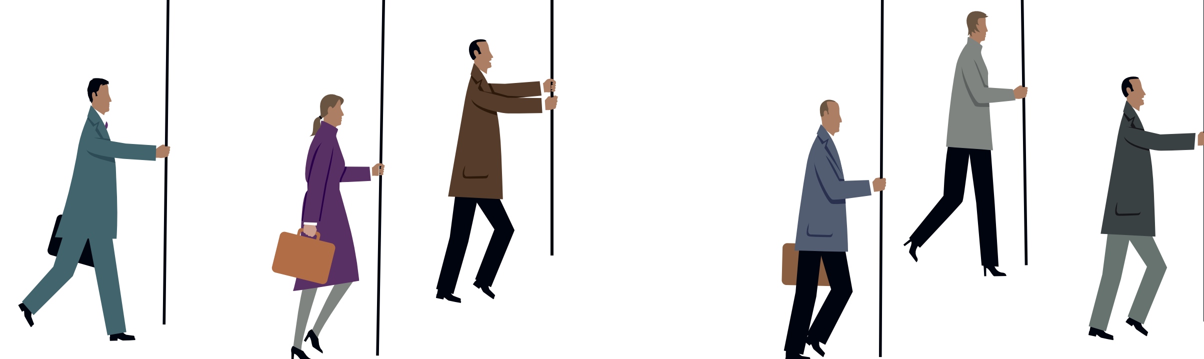
Although collaboration offers many benefits for consumer goods manufacturers and retailers, too often their joint initiatives don't work out. To ensure success, partner companies should take these six actions together.

Copyright 2012 CSCMP's Supply Chain Quarterly

6 steps *to successful supply chain collaboration*



MARK AIRS/ISTOCKPHOTO.COM

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.[1] 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.[2]

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

[BY LUIS BENAVIDES, VERDA DE ESKINAZIS, AND DANIEL SWAN]

the enthusiasm for further 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 outline six 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 they need from senior management to drive the collaborations, 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 initiatives must align two separate organizations. To make the collaborations work, the players involved must navigate differences in organizational design and culture. At the same time, a history of difficult relationships can make partners reluctant to share important information, leading them to work on their parts of the "collaboration" 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 targets. These misaligned incentives arise because different players in the supply chain may see the world in very different ways. A manufacturer, for instance, might want to grow its market share by improving its own offerings relative to competitors, whereas a retailer might be interested in increasing sales or margins across the category, not in changes to product mix.

This difference in outlook can mean that retailers and manufacturers want very different things from the collaboration. Growth-focused manufacturers may be enthusiastic about new promotional opportunities, while retailers operating on thin profit margins may be much more interested in taking cost out of product handling and storage. The relationship and power dynamics between collaborating partners can be dramatically different, too. Manufacturers typically will have relationships with a small number of key retailers, while those same retail partners will have relationships with hundreds of different suppliers.

The following case of a major food manufacturer and a retail chain provides an instructive example of how collaboration can go wrong when participants don't trust each other enough. The two companies agreed to collaborate on a co-branded product line. The retailer hoped that the manufacturer's brand name would boost both the credibility and the sales of its product, while the manufacturer saw the partnership as a way of increasing its own market share within the retailer's network.

The collaborative effort failed to play to either company's strengths, however. The retailer's rich point-of-sale and consumer-preferences data provided 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 reassess their relationship.

Making the right choices

Consumer packaged goods companies can greatly improve their prospects for 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. In practice, 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 own 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.

Potential collaborators should also be sure they have the right supporting infrastructure in place in

[FIGURE 1] SIX KEY STEPS TO SUCCESSFUL COLLABORATIONS

Where to collaborate

1. Collaborate in areas where you have a solid footing
2. Turn win-lose situations into win-win opportunities with the right benefit-sharing models
3. Select partners based on capability and strategic alignment, not just size

How to collaborate

4. Invest in the right infrastructure and people
5. Jointly manage performance and measure impact
6. Collaborate for the long term

[SOURCE: MCKINSEY & COMPANY (2012)]

advance of any collaborative effort. Is top management committed to the collaboration process and ready to offer support over the long term? Are in-house information technology (IT) systems robust enough to facilitate real-time data sharing if required?

2. Turn win-lose situations into win-win opportunities with the right benefit-sharing model.

Some collaborations promise equal benefits for both parties. If, for example, a manufacturer and a retailer collaborate to optimize product mix, both could expect to benefit from the resulting increase in sales. In other cases, however, the collaboration might create as much value overall but the benefit could fall more to one partner than to the other. Here's one real-life example: a retailer and a manufacturer were able to reduce overall logistics costs between factory and store by cutting out the manufacturer's distribution centers and treating the retailer's distribution network as one integrated supply chain, from manufacturing plant to store shelf. However, the retailer's supply chain executives struggled to gain acceptance for the idea from their leadership because it resulted in the retailer carrying a far larger fraction of the logistics cost.

Rather than shying away from such asymmetric collaborations, smart companies can make them work by agreeing on more sophisticated benefit-sharing models. These can come in the form of discounts or price increases to more fairly share increased margins or cost reductions, or they can involve compensation in other parts of the relationship. For example, when one retailer collaborated with a manufacturer on a co-branded product line, the manufacturer agreed to absorb the upfront product-development costs in return for an expanded share of the retailer's product offerings across a wider set of categories.

Benefit sharing can help to overcome differences in strategic priorities, too. One growth-focused manufacturer was persuaded to join a supply chain waste-reduction collaboration with a retailer by establishing an agreement to deposit part of the savings both companies achieved into a joint pool, which would then be invested in efforts to generate additional sales.

Similarly, in the product-flow improvement case described in the sidebar (page 26), the manufacturer provided the upfront investment in new retail-ready packaging, while its retail partner reaped most of the benefits in terms of increased availability and reduced labor costs. The two companies established a joint benefits pool and agreed to use a percentage of the savings to fund future cost-reduction efforts and a sales-improvement program.

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 assesses current customers or suppliers across three key dimensions. First, is there enough potential value in collaborating with this 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, do both partners have sufficiently common strategic interests to support the collaboration? A retailer that has prioritized growth in a particular region or segment will have more to gain from collaborating with a manufacturer that has a strong offering in the same area. Third, does the partner have the right infrastructure and processes in place to provide a basis for the collaboration? Collaborating 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, assuming that staff in various functions can do what's required in addition to their other responsibilities.

Copyright 2012 CSCMP's Supply Chain Quarterly

In practice, even relatively simple collaborative tasks will be 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.

Disconnects within one organization can create problems, too. A "grassroots" 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 collaboration 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 for the manufacturer, and from purchasing, 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.

Copyright 2012
CSCMP's Supply Chain Quarterly

[OPPORTUNITIES FOR COLLABORATION]

In McKinsey & Company's work with consumer goods manufacturers and retailers, we have identified six broad areas where companies can collaborate for mutual gain:

- Category strategies
- Merchandising and in-store layout
- Joint innovation
- Demand planning and fulfillment
- Collaborative sourcing
- Joint flow efficiency

The final three of these have direct supply chain implications, and in each case, successful collaborations have delivered profound improvements in supply chain performance. The following are some examples we have seen:

A beverage manufacturer and a retailer collaborated to improve **demand planning and fulfillment.** Prior to the collaboration, the retailer's ordering process did not match changes in consumer demand, with the result that shipments from the manufacturer fluctuated twice as much as did retail sales. To avoid stock-outs under this regime, both the manufacturer and the retailer were forced to keep high levels of inventory on hand.

Working together, the manufacturer and retailer agreed on a joint forecasting and demand-analysis system. They improved their information sharing, too: the retailer gave the manufacturer access to its on-shelf availability data, which allowed the two companies to modify product distribution to maximize availability in individual stores, while the manufacturer informed the retailer about supply constraints that might limit its ability to meet high levels of demand at short notice. The partners also agreed to stagger promotional activities among regions to reduce overall demand peaks. The introduction of the new system cut shipment volatility by one-third, allowing both the retailer and the manufacturer to achieve inventory reductions of more than 15 percent and increase profit margins by 3 percentage points.

Another area for fruitful collaboration is sourcing. One large U.S. retail chain has used **collaborative sourcing** to great effect across a broad range of categories and geographies. In an effort to combat rising raw-materials prices in key categories, the company established joint sourcing programs with manufacturers to purchase key commodities for both its own private-label products and the manufacturers' brand-name items. Collaborations have included the sourcing of potatoes for chips manufactured in the United States and sugar for soft drinks manufactured in the United Kingdom, with the latter effort securing a 14-percent cost saving.

Finally, the case of a retailer and food manufacturer shows how collaboration can work to dramatically improve product **flow efficiency.** The manufacturer produced packaged foods in a large assortment of flavors, making it difficult for its retail partner to manage inventories across the category. This required time-consuming and labor-intensive efforts to keep the shelves stocked.

The two companies tackled these issues by developing retail-ready packaging that made it easier to keep the shelves stocked while also optimizing the way delivery trucks were loaded. The new packages were designed to fit into jointly developed in-store display units that held more products and made items easier to find than the conventional shelves they replaced. As a result, the average time it took consumers to select an item dropped from 58 seconds to just 8 seconds. The companies then changed the replenishment system to accommodate the new display units. They segmented various retail sites by volume, velocity, and volatility, and then optimized shipment sizes and replenishment frequency for each segment. For the highest-velocity stores, the partners introduced a rapid-replenishment program in which deliveries were timed to coincide with peak selling days.

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. The best companies avoid forcing their front-line staff to "reinvent the wheel" by providing strong support when establishing each new collaboration. They may, for example, leverage experience gained in previous collaborations by setting 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 is on track and delivering the results it should. In supply chain collaboration efforts, both participants should use the same performance-management system. By building common metrics and targets—and jointly monitoring 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 processes, 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 to overcome these potential conflicts? The trick is to keep things simple by picking the smallest possible number of metrics required to give a picture of the collaboration's overall performance, and then to manage 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 this frequent, robust dialogue between partners, yet this is also the element most commonly ignored or underemphasized by collaborating companies.

6. Collaborate for the long term.

The final vital ingredient of a successful collaboration is stamina. It may take time and effort to overcome the initial hurdles and make a new collaboration work. Both parties need to recognize this and build an appropriate long-term perspective into their goals and expectations. This means including metrics that review performance beyond the first year, as well as conducting joint, long-term planning so both partners can understand each other's longer-term objectives and identify initiatives they can work on together over time. Such planning helps companies to break out of the short-term-project mentality that can limit the beneficial impact of collaboration. Nevertheless, partners must also ensure that they are doing everything they can to capture any available quick wins, so the collaboration starts delivering value as quickly as possible.

When companies take a long-term perspective, their collaborative efforts can become a virtuous circle: a greater understanding of each other's capabilities, knowledge, and costs will often reveal new potential sources of value, while the experience of working closely together means that later 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 our experience, successful CPG collaborations that involve two or three separate initiatives in a category deliver a return that's equivalent to a profit uplift of 5 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 collaborative intensity with their top 10 retailers could boost margins by 5 percentage points. And for the North American CPG sector as a whole, that kind of impact could potentially be worth US $8–$12 billion—comparable to two years of industry growth. △

Notes:

1. Unpublished result from *2008 Customer and Channel Management Survey—Doing More with Less: Winning Sales Strategies to Navigate a Challenging Market*. Grocery Manufacturers Association (2008). www.gmaonline.org/downloads/research-and-reports/CCM_2008_FINAL.pdf
2. *2010 Customer and Channel Management Survey—Emerging from the Storm: How Leading Customer Organizations Reignite Growth*. Grocery Manufacturers Association (2010). www.gmaonline.org/downloads/research-and-reports/CustomerChannelCollaboration_2010.pdf

———

LUIS BENAVIDES (LUIS_BENAVIDES@MCKINSEY.COM) IS AN ASSOCIATE PRINCIPAL, VERDA DE ESKINAZIS (VERDA_DE_ESKINAZIS@MCKINSEY.COM) IS A CONSULTANT, AND DANIEL SWAN (DANIEL_SWAN@MCKINSEY.COM) IS A PRINCIPAL, ALL AT THE GLOBAL CONSULTING FIRM MCKINSEY & COMPANY.