

PUTTING TOGETHER STRATEGIC TRADING PARTNERSHIPS

FOR COMPETITIVE ADVANTAGE



In 2009, CPG companies will need to make hard choices about where they invest resources — especially when it comes to the retail customer. ROI is mandatory in the current economic environment, so if you're not effectively segmenting your trading partners on the basis of potential return and working with them to strategic advantage, it's time to start. Here's how.

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Often, companies who do not work effectively with trading partners don't know it, or don't know they're missing out. Sometimes they do -- but they don't know why.



Today, you MUST differentiate. Somehow, you must set yourself apart in the marketplace. You know it, and your retail customer knows it.

As the vice chairman of one leading mass merchandiser said recently, quoted in *Supermarket News*, "...For us to compete in the future, we cannot be all things to all people ... we must work together with our vendor partners to provide unique value to our customers..."

But while most CPG manufacturers and retailers know they need to differentiate their products and stores, too many are still approaching trading relationships if they were largely equivalent.

They're not. And today, you can't afford to act as if they were. If you do, not only will you fail to get the ROI you need, but you will miss out on huge opportunity — the opportunity to gain market advantage by working strategically with the right trading partners up and down the value chain.

Factors Converge, Driving Partnership Importance

Indeed, at present a number of factors — our precarious economy, consumer consumption trends, retailer consolidation, and the differentiation imperative — are coming together. The impact is such that the only conclusion one can reach is that gone are the days when trading partners could afford to work at cross purposes, creating lose/lose situations, or unilaterally, failing to take advantage of what a partner can bring to the table.

Often, companies who do not work effectively with trading partners don't know it, or don't know they're missing out. Sometimes they do -- but they don't know why. For example, several years ago I was working with a major CPG company to help analyze its customer base, and understand with which retail organizations it was making money, and which it was not. This supplier's goal was to begin putting its major resources where the biggest profit returns would be.

I was also working with a major regional retailer; this company was trying to learn how it could better partner. One afternoon, the vice president-merchandising called me, and said, "Peter, I know you're working with (major CPG company). Why aren't we getting more trade dollars from them? We notice that, over the last two years, the trade dollars and the number of promotions they're running with us have declined significantly.

"We also notice that a vice president used to call on us. Now it's a just junior salesperson."

The vice president-merchandising knew something was awry, but he didn't know what. He had also observed what is happening more and more: At more and more companies today, resources include human capital and talent: "We are going to put my best people, as well as my money, against our best customers."

"What's going on?" the retailer wanted to know.

Because my work with the CPG company was confidential, I couldn't answer directly. But I did reply that this company was involved in a process of evaluating how to decide where to put its resources. I pointed out that in today's economy, no supplier can afford to invest resources where there is no return.

I then facilitated an introduction — the vice president of merchandising and his counterpart at the CPG company — so that the problems could be surfaced and addressed.

Other leading companies have long since acted on this realization. Consider Procter & Gamble's "Connect & Develop" program, implemented in 2003. P&G saw that to be successful in the future, it would have to look beyond its own walls for innovation, partnering with its customers and others along the value chain.

Accordingly, today P&G partners with its suppliers and its customers — and also beyond traditional trading relationships - with entrepreneurs, universities, even competitors.



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Look Beyond a Step Up or Back

Like P&G and other leaders, you too need to look beyond your immediate customers and suppliers, because new ideas, innovative capabilities and opportunities actually increase the further you reach beyond where you are in the value chain.

How many companies do this?

Some have been doing it for quite a while. About 10 years ago, I worked with Sainsbury in the UK on a project centered on how the company could develop an understanding of supplier profitability and ultimately improve relationships with partners.

Sainsbury had a very interesting department within Marketing and Product Development called "Search and Reapply." Its head had what might be considered a "dream job": Twice a year, she got to fly about 10 people somewhere in the world and spend about two weeks on site, looking for new ideas, new approaches, new products, new partnership opportunities.

At the time of my Sainsbury project, Starbucks had no stores in Europe, though they were testing a few in the UK. The

Search and Reapply team was planning a trip to Japan. I happen to live in Seattle, and the head of the group suggested that, on the way back from Tokyo, they stop off there.

Knowing Starbucks's COO at the time, I arranged for the Sainsbury group to meet him — and out of that meeting came the first Starbucks stores to open inside Sainsbury supermarkets.

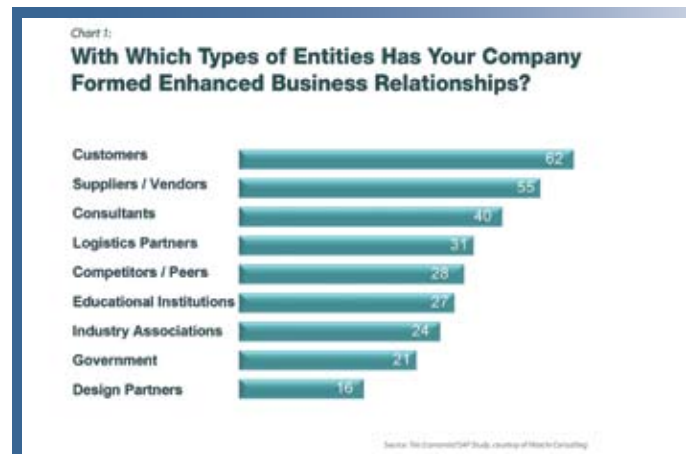
It was the first of many. Today as then, the best partnerships answer the question: How can we take what is unique in a marketplace, and do something different with a trading partner?

State of Strategic Partnering 2009

Where are we now, at the start of 2009? What are companies thinking about value-enhancing partnerships?

Recently, *The Economist* published a study targeted to the CEO, CFO and other C-level executives. Sponsored by SAP, it was based on responses from 516 companies worldwide, and suggests what companies are thinking about in terms of strategic partnering, or "enhanced business relationships."

Respondents were permitted to give multiple answers. The accompanying Chart 1, "With Which Types of Entities Has Your Company Formed Enhanced Business Relationships?", shows that 62 percent said they were working with their customers and 55 percent were working with their suppliers or vendors. But a full 28 percent were also working with competitors or peers, 27 percent with educational institutions, and 21 percent with government.





In the case of one supplier and retailer, there was no local authority to tailor the trade funds. Just by working together more closely, the partners unbundled their trade funds and put additional resources against new product development. Result: Sales rose by \$6 million, and profitability improved by 7.2 percent.

The survey also asked for respondents' main partnering objectives. Predictably, for most companies the goal is to get closer to the customer, to better understand the customer company's needs and requirements.

It should be noted, by the way, that not one of the top four objectives cited were related to cost reduction. Rather, all are market-related, centering on customer centricity, new products, speed to market and geographic expansion (Chart 2, "What are the Main Objectives Your Company Seeks in Improving Business Relationships?")

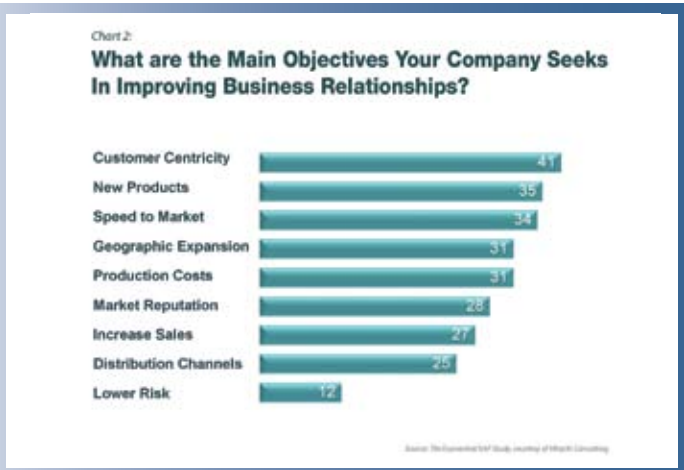
With so much money involved, trade promotion management is always a major opportunity. For example, in the case of one supplier and retailer with whom I worked, there was no local authority to tailor the funds. Just by working together more closely, the partners unbundled their trade funds and put additional resources against new product development. Result: Sales rose by \$6 million, and profitability improved by 7.2 percent.

And it all came about when two companies sat down at the table, and agreed to become strategic partners.

...But Don't Neglect Cost Opportunity

This isn't to say that cost-focused partnerships aren't worth pursuing. Consider the weird, square milk jug now found at Costco and Sam's (see box, "Example: Efficiency via Packaging Innovation"). Consumers say they hate it. But they buy it, because the price of milk in that jug is roughly 23 cents a gallon less than milk in the typical jug.

Why? Recently, *The New York Times* wrote about this new jug configuration, and included a chart showing how milk arrives at many supermarkets — in the typical gallon jug in little plastic crates — compared to the way it arrives at Costco: efficiently palletized. The *Times* pointed out what every retailer knows: Traditional milk jugs cannot be stacked; they require those crates for storage and transport. The new jug, by



That's interesting, because in the past and even now, many people still assume that cost reduction is the primary purpose of partnership — in fact, as the survey confirms, companies use partnership to develop products and grow sales.

Another survey question is represented in Chart 3: "In What Functional Areas Will Your Company Focus to Create Business Partnerships?"

Essentially, respondents said these areas are sales / distribution, marketing, R&D and customer service. All of these relate, of course, to increasing sales. As Chart 3 shows, the more cost-focused areas tend to fall to the bottom of the list.



Example: Efficiency via Packaging Innovation

Efficiency, One Gallon at a Time

Sam's Club is adopting a new, stronger milk container design that will streamline packaging, maintenance and delivery at lower cost to its customers. Other retailers may follow suit.

	TRADITIONAL	JUG NEW DESIGN	IMPACT
Packaging and Storage	Traditional milk jugs cannot be stacked and require crates for storage and transport.	The new milk containers have flat tops and ridged sides that allow multiple stacking, bound by cardboard bands and shrink wrap.	By eliminating the crates, the new containers store 4.5 gallons of milk in a cubic foot — 50 percent more than the 3 gallons stored in a cubic foot with the old jugs.
Maintenance	Plastic crates are reusable after being returned and washed.	After single use, the cardboard and shrink wrap are recycled.	No water is needed for washing, and no labor is required to load and return the crates.
Transport and Fuel	Four to five trips a week are required to deliver milk to a typical Sam's Club.	Two delivery trips are required each week.	Fewer trips by delivery trucks reduce fuel cost and consumption.



Source: Superior Dairy/The New York Times, courtesy of Hitachi Consulting

But the fact is, all retailers are not equal performers for the supplier — and vice versa. Efficient retailers subsidize the inefficient. That's because most vendors develop their pricing by averaging their costs. These costs include those of doing business with the inefficient retailers as well as the efficient ones.

contrast, has a flat top and ridged sides that permit stacking; all that's required for shipment are several cardboard bands and shrink wrap.

It was Superior Dairy that came up with this new design. Benefit: Milk no longer needs to be removed from crates. At Sam's Club, this simple change has reduced deliveries from four or five a week to two, while cutting labor costs.

Manufacturer outsourcing can be another opportunity, as the case of one cheese marketer shows. By going outside instead of buying from his own internal production operation, the CFO is now saving 13 percent. He passed five percent of that onto the stores, and kept seven percent inside — for a nice bump to profits.

Chief Obstacle: Trust

What hurdles do companies face in trying to create such productive partnership ventures? According to *The Economist* survey's respondents, the top three issues are:

- Trust regarding information-sharing
- Conflicting cultures
- Contractual terms

How do companies overcome these problems? What do you need to consider when undertaking strategic partnering?

First, consider the process from a retail perspective. As any CPG executive who has ever called on a supermarket knows, the biggest fear of any retailer is that it is not going to get the best price from the manufacturer.

The good retailers have begun to recognize this. So, more and more, those who are efficient — who don't deduct from the invoice, who execute on promotions, who pay on time — are saying to the supplier: "Wait a minute. I'm a good trading partner for you. Why do I pay the same price as the retailer who deducts? I want that difference in cost to you reflected in a better price to me."

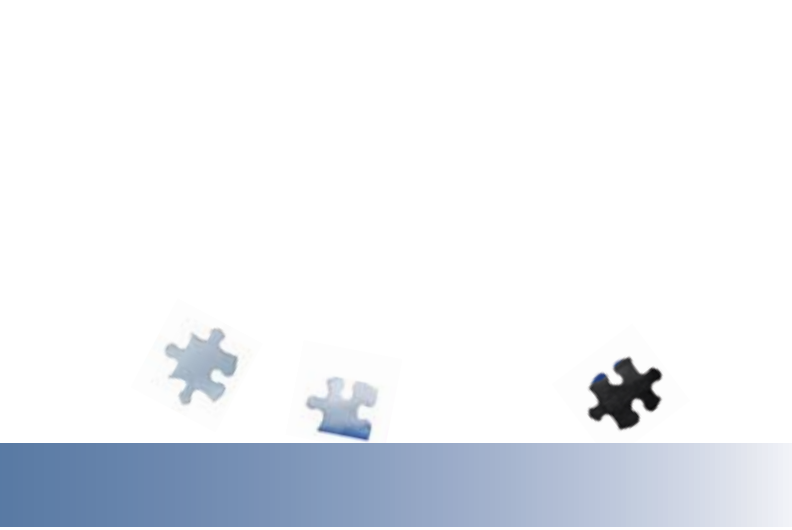
On the other hand, smart retailers also recognize that they make more money with some suppliers than with others — their products sell better, they have better-integrated operating practices; they and the retailer are better linked, they transmit orders and invoices electronically. In short, thanks to supplier competence, they do things better together.

Suppliers, for their part, are less and less eager to invest in such efficiency on behalf of the retailer, and get nothing in return. To CPG manufacturers, it especially galling that, because the retailer evaluates its suppliers largely on, say, gross margin, it gets no "credit points" for the fact that its trucks arrive on time, that it has developed special packaging to reduce damage at retail, that it reduces error by transmitting orders and invoices electronically.

Establish Criteria, Set Clear Standards

Clearly, to establish trust and pave the way for strategic partnerships, suppliers and retailers alike need to articulate the specific performance "ground rules." That way, each side knows what the other expects, and what it needs to do in order to benefit from and maximize the potential of the relationship.

What is the methodology that allows trading partners to work more productively together, thereby adding value to each



other's business? Six characteristics are found in the most successful strategic vendor partnerships:

1. An all-inclusive view of the trading relationship. Each trading partner should start by looking at partners holistically, and then begin to treat them differently, based on characteristics that they define. Chart 4, "A Holistic Look at All Elements of the Trading Partner Relationship," provides an overview of opportunity areas.

2. Clear, documented trading expectations. Documenting policies in regard to your trading partners is not being adversarial or overly rules-bound. Rather, taking the time to think through and develop a framework for working together clarifies expectations on both sides. It enables you to decide whether you really want to work together, and sets the stage for win/win. Measurement is key, making scorecards an integral part of the documentation process.

3. A direct link between scorecard placement and the status of the trading relationship. If trading partners do things well together, they have a good relationship — and a good relationship leads to doing bigger things together and an even better relationship. If they don't, they don't do as much business together.

In the latter case, the message — spoken or implied — is very much what the CPG company with which I worked

was saying to the regional retailer when it replaced a vice president with a junior salesperson on the account: "We're just not working well together."

4. Mutual understanding that all relationships are not equal. Strategic trading partners strive to find the unique potential in each other, and decide together how best to maximize it.

Working with a strategic partner should be very different from the traditional supplier/retailer relationship. Typically, a buyer says to a supplier: "What's your deal? What are your trade promotion dollars? What's your gross margin? What do you want to buy?" Strategic relationships look beyond this typical exchange. Like Sainsbury and Starbucks, the partners think big and out of the box.

5. Appropriate organizational structure, cross-functional alignment and rewards that encourage the desired behavior.

Today, a typical retail procurement or merchandising director is measured on his or her net margin contribution. And if you're a supplier, you have probably had the unsettling experience of being on the receiving end of a large undocumented invoice deduction — with no idea what it was for. Sometimes, you discover there was no reason — except that the retailer didn't make its quarterly profit number. So they have deducted to make the number, and will now try to figure out how to pay you back in the coming quarter.

6. Open communication and a win/win orientation. Both of these are easier to achieve when you begin to align more closely with partners who bring something to the table beyond merely product or a low price on it.

Imagine the opportunity if a retailer came to you and said, "I'm trying to target aging consumers. Here are the demographics



Chart 4:
**A Holistic Look at All Elements
Of the Trading Partner Relationship**

Manufacturing and Logistics	Customer Service and Finance	Marketing and Sales
<ul style="list-style-type: none"> • Contract Manufacturing • Direct plant ship • Customer pick-up • Shipment notification • Delivery platform • Unload process • Truck turnaround time • Truck waiting limits • DSD • Pallet Layer Increments • Lead time • Order configuration 	<ul style="list-style-type: none"> • EDI • Forecasting / Integrated Planning • Information Sharing • Damage Policy Compliance • Returns Policy Compliance • Promotional Deductions • Unknown Deductions • Limit penalties or Fines • EFT • Financial Communication • Compliance with Terms 	<ul style="list-style-type: none"> • Retail Coverage • Reset Coverage • Contract Pricing • Discontinued Items • Diverting • New Item Performance • Trade Promotion Funding • Integrated Promotions • Store Level Promotions • Co-branding Products

Chart 5:

Strategic Retailer Partnership / Program Architecture Sample Vendor Segmentation Matrix



of my market and what my stores look like. Forty percent of my potential new customers are over age 55. You know, if we really worked together on this, we both stand to gain. What products can you bring me, what products can we jointly develop, that will appeal to this target market?"

As a supplier, you can make the same proposal to a retailer.

In short, think value — not cost. Today, there are a host of value drivers — areas where you can partner to improve performance — manufacturing, marketing, new item introduction and performance, retail shelf and displays, customer service, finance, logistics and more.

As these opportunity areas are identified, the relationship becomes broader, deeper and stronger. It grows beyond the traditional sales rep / buyer relationship, and becomes cross-functional. Each company begins to look at all components of its organization, and at how the two companies can work together in multiple ways.

How to Segment for Strategic Partnering

As we have said, all trading relationships are not equal. So, how do we segment our trading relationships, and what do we do for each segment?

A matrix segmentation is illustrated in Chart 5, "Strategic Retailer Partnerships / Program Architecture ...". Such a matrix may seem simplistic, but it is key to driving home to your organization that not all trading partners are the same, and to maintaining focus. An organizing principle such as the matrix helps delineate the boundaries, and clearly says that some are more important to achieving your goals than others.

This supplier, for example, segmented on volume and profit — an obvious, foundational differentiator — as well as alignment with its own strategy and standards. The former is objective and easy to measure, the latter somewhat subjective.



For many suppliers, a strategic partner will be Wal-Mart, Kroger, Safeway or other major chain, or a strong, innovative regional player like Wegmans.

For many supermarket chains, a strategic partner might be a Procter & Gamble, Unilever or Kraft, a company that brings major national brands and large resources to the table. For an operator such as Whole Foods, the criteria will be very different — upscale, organic, health or "green."

In other cases, the criteria may be something else again. For example, one retailer with whom we have worked does great volume in alcohol — but does not desire strategic partnership programs with major brewers. Essentially, it is uncomfortable marketing alcohol, and therefore puts its alcohol suppliers in a "tactical" bucket; brewers and other alcohol suppliers simply are not considered to be in alignment with the retailer's overall positioning strategy.

For a retailer seeking to differentiate itself via innovation, a strategic partner might be identified as a supplier— even a very small one — that is producing a stream of interesting new products with appeal to the retailer's target market.

Chart 6:

Sample Trading Partner Resource Allocation Based on Relationship Status



Source: Merck Consulting



Standards for trading partner performance help delineate and clarify who your high-performance trading partners are.



Finally, a transactional partner may be a company whose products are staples — the retailer simply must have them in the store.

Once its potential partners are segmented, a company — whether supplier or retailer — needs to decide how to act toward those segments. Sample tiered approaches are depicted in Chart 6, “Sample Trading Partner Resource Allocation Based on Relationship Status.”

With top-tier strategic partners, the company may decide, for example, to hold quarterly top-to-top planning meetings featuring full disclosure.

With bottom-tier companies, by contrast, trading partners may simply negotiate hard on price.

Standards for trading partner performance help delineate and clarify who your high-performance trading partners are. To develop these standards, decide what has an impact on your bottom and line, and set standards around these activities and functions. Some sample supplier standards are suggested in Chart 7, “Strategic Vendor Partnership Architecture / Sample Vendor Performance Standards.”

Some trading partners will be able to meet these standards; many will not. For companies willing to stretch to meet them, give credit where credit is due, and move them onto the scale where they have a chance to prove themselves as, say, an innovative partner. Do a pilot or two. See if they are willing to adjust and improve.

One retailer with whom we worked had a policy objective for each element of operations — on new item introductions, for example, it was to improve speed and accuracy of new item setup. In conjunction with this policy, the retailer had defined as a minimum standard for each of supplier: “to provide error-free item information in the documents they send us.” And to be considered “Best in Class,” the supplier’s item information needed not only to be accurate, but to be transmitted electronically, in a specified format.

Acting on Trading Partner Segmentation

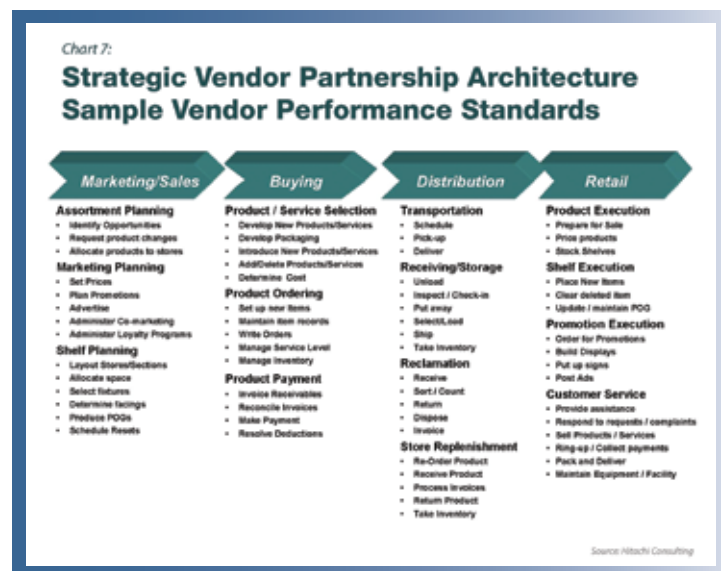
For companies seeking to improve the partnership management process, if you have done the appropriate segmentation, you must now decide how you will behave differently.

With strategic partners, you might undertake leading-edge development or investment-grade new-product pilots, or advanced forecasting and long-term business planning.

Because such opportunities are directed only to strategic partners, this work has an advantage besides the business improvement generated with strategic partners: It can create, in “tactical” partners, the desire to be strategic, elevating their performance and creating additional opportunity — and so it grows.

Innovative partners might be invited to create or test new concepts, invest jointly in new programs, or develop best practices.

Tactical partners might focus their work together on improving efficiency.





In short, the work is very different, based on the appropriateness of the trading partner — which, again, has been determined by the segmentation process.

Becoming Trustworthy

Which brings us back to trust: All the above efforts require a great degree of trust on both sides, because all require sharing sensitive information.

What is the best way to develop the necessary initial level of trust? According to the Economist survey, it's through personal relationships, understanding, flexibility, mutual goals and shared rewards.

One good way to approach this is to say to a trading partner: "Okay, how can you show your potential partner that you are serious about making this effort?" Because in all probability, the trading partner on the other side does NOT trust you.

In our experience this requires four commitments, to:

- Disclosure
- Access
- Resources
- Advocacy

If you decide with strategic partners that you are going to disclose information, you encourage your trading partner to do the same. Just as in a personal relationship, if you open up, the other person will usually open up.

■ **Disclosure:** What you will disclose is important to think about. If you disclose movement data or profitability analyses, this will elevate the discussion and build trust.

■ **Access:** With whom in the trading partner organization will you interact? If you charge your lead people with meeting their counterparts, you will elevate the relationship, also building trust.

■ **Resources:** Investment of time and assets speaks volumes about your commitment to the process and to results — building more trust.

■ **Advocacy:** This can be the biggest trust-builder — and also the hardest to demonstrate. An advocate demonstrates goodwill. He or she gives you the benefit of the doubt. In our experience, this is often very difficult for retailers especially to do something like support a vendor partner in a meeting. But if you can, you can make huge deposits in your "trust account."

Additional ways to build trust:

■ **Appoint a formal relationship manager to ensure that someone within your organization "owns" the relationship.** A single point of contact, communication and internal advocacy for the partnership — a person who promotes the partnering concept and makes sure the relationship is going somewhere — can help assure that the strategic partnership's potential is tapped and maximized.

■ **Make sure you have strong IT capabilities, particularly business information reporting, analytics,** and especially profitability analysis. After all, if you can't measure the success of the partnering effort, it won't achieve your goals for it. And because many initial pilots tend to center on supply chain opportunities, supply chain software is also important.

How to begin? It's important to do the right foundation work. Who are you in the marketplace? *Who do you want to be? What are your objectives? With whom should you to partner for the best chance*



of achieving them? Segment, figure out how you will measure performance and progress, and pick your strategic partners.

The next step is to collaborate on picking some pilots. By working together, you will build more trust and further improve the relationship, setting the stage for more ambitious efforts — a virtuous circle.

Summary: Strategic Partnering is Key to Future

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