Gaining a Competitive Retail Advantage with... → **...Vendor Compliance Optimization...** → **...Accountability, Visibility, and Predictability**

Remember the old business maxim – 9 out of 10 unhappy customers don't complain - they just take their business elsewhere. When the right merchandise does not make it to the store at the right time, in the right quantity, in the right configuration, and in good, saleable condition, it is a lost sale waiting to happen.

Unfortunately, the problems don't stop with lost sales and lost customers. When the supply chain fails to effectively execute the merchandising plan, buyers struggle to plan future purchases. Sales data that is corrupted by factors other than customer purchasing habits loses value as a forecasting resource.

Without intervention, the cycle will continue: poor buying planning caused by poor-quality historical sales data, followed by a badly executed merchandising plan. The outcomes include (but are not limited to):

- Lost revenues due to lost sales and markdowns,
- Lost or disappointed customers,
- Labor costs necessary to resolve problem shipments,
- Holding unsold inventory until the next sales season,
- Inadequate distribution service levels,
- Ineffective merchandise planning,
- Ineffective supply chain planning and execution.

A best-in-class Vendor Compliance program enables retailers to gain control of their supply chains by providing accountability to vendors and other stakeholders, visibility into internal and external supply chain activities, and predictability for future supply chain performance. The Retail Supply Chain Challenges table (Table 1, above) illustrates the stakeholders, the challenges, the solutions, and benefits of managing supply chain performance.

Retail Supply Chain Challenges (Table 1)

Objectives	Stake-holders	Challenges	Solutions	Benefits
Optimize supply chain execution of the merchandising plan	Retail supply chain • Merchants • Vendors • Carriers • Logistics • Traffic • Distribution • Allocation • Replenish-ment • Transporta-tion	Vendors fail to comply with the retailer's fulfillment requirements **Non-compliance causes:** • Over/Short PO fill rates • Late/Early shipments • Poor ASN accuracy • Trouble shipments • Poor distribution service levels	Recover cost of correcting supply chain problems Vendor Compliance Optimization Supply chain data warehouse • Complete • Accurate • Accessible	Recovered dollars directly to bottom line • Increased margins and profits • Increased earnings per share
Optimize merchandise planning				Optimized merchandising planning
Optimize supply chain support of enterprise objectives		Problems preclude the supply chain from effectively executing the merchandising plan Failure to execute the merchandising plan causes:	• Vendor scorecards • Automated reporting • On-line data	Optimized sales due to effective execution of the merchandising plan
Optimize retail profits and shareholder value	Store Operations Senior Retail Leadership Vendor Compliance Staff	• Lost sales • Unnecessary markdowns • Inadequate data for supply chain planning	Collaborative planning and execution	Ongoing supply chain performance improvement

Ineffective supply chain execution of the merchandising plan can preclude a retailer from accomplishing its enterprise business objectives and long-term strategies. Loss of revenue and increased operating costs do not contribute to the achievement of profit targets and shareholder value expectations.

According to a 2004 Soleus Group survey of U.S. retailers, only 87.5% of shipments arrive on time and order fill rates equal a dismal 93.7%. These vendor performance failures place additional burdens on the retailer's internal supply chain, which is often struggling to manage its own operational issues.

It is tough to fix something that you don't know is broken. Most retailers don't capture the data necessary to know whether or not vendors are meeting on time and order fill rates standards.

Few business areas need to be measured more extensively, more frequently, and more effectively than logistics. Yet current measurement practices still leave much to be desired, according to James Keebler, Ph.D, and author of "Keeping Score", one of the latest books on supply chain management. Keebler, an assistant professor with St. Cloud State University, says there is a strong association between measurement and operational performance, yet research on the logistics measurement programs of more than 350 companies shows that many firms do not comprehensively measure.[1]

[1] Julia Kuzeljevich, *Keeping Score: Developing an Effective Strategy for Supply Chain Management* (The CEO Refresher, 2001)

The Stephen Covey quote (top of the page) describes the hazards of making business decisions based on bad information, corporate mythology, and biased assumptions. Retailers simply cannot afford to develop merchandising plans, supply chain plans, and other plans and strategies while handicapped with inaccurate and incomplete supply chain performance data. Regarding the impact of vendor compliance on profitability:

Profits, in a very large sense, are an accounting anomaly. They cannot be directly managed or controlled, and their existence is dependent on a host of variables.
At first glance, the preceding statements may seem curious. However, their veracity becomes apparent when it is realized that profits, or their absence which is generally termed a "loss", are the *residual difference* between revenues and expenses.
In fact, *no* residual can be directly controlled. Only the factors of which the residual is a factor may be controllable – thus it is with profits. Management can influence revenue (i.e., sales) and expenses in a variety

[2] Recovery of Lost Profits – Reasonable Certainty, *From the Witness Stand* (UHY Advisors, Spring 2006), Page 1

of ways. The degree of success of those efforts will manifest themselves through their ultimate impact on profits.

Vendor Compliance Optimization

A well-planned and executed Vendor Compliance Optimization program (also known as Supplier Performance Management) can enable a retailer to measure supply chain performance, and align its vendor community with the organization's strategic goals to systematically eliminate avoidable costs and improve bottom-line performance in as little as 120 days.

One vendor addressing this area is Compliance Networks, which offers a supplier compliance optimization package. The product highlights supplier noncompliance and aids in the development of suppliers as partners working together to meet demand.

While solving supplier compliance issues isn't a simple fix because changes in human behavior are required, implementing a system like Compliance Networks is a great is opportunity for companies to facilitate change and optimize supplier compliance.[3]

Vendor Compliance Optimization offers an effective, comprehensive, and affordable solution that enables the retail enterprise to optimize supply chain execution of the merchandising plan, provides visibility into supply chain activities, and provides comprehensive and accurate supply chain historical performance data to support merchandise planning and supply chain decision-making. The Vendor Compliance Optimization Benefits table (Table 2, right) illustrates the value that retail supply chain stakeholders realize from an effective Vendor Compliance Program.

Vendor Compliance Optimization Benefits (Table 2)

Management Information	Merchants	Vendor Compliance	Distribution and Logistics	Retail Enterprise
Supply chain data warehouse that provides accessible and actionable supply chain information	Maximized PO fill-rates	Vendor scorecards that are complete, accurate, and fair	Maximized distribution service levels	Recovered dollars directly to bottom line
	Maximized on-time shipping		Minimized labor expenses	Maximum flow of merchandise through the supply chain to stores
Graphical User Interface that enables and facilitates on-line data visibility, analysis, reports, automatic reporting, correspondence management, and violation/charge research.	Optimized supply chain execution of the merchandising plan	Optimized vendor compliance activities via automated detection, defense, communication, reporting, and charge recovery	Optimized supply chain activities	
			Optimized cross dock usage	Ongoing vendor compliance improvement
	Accurate and comprehensive visibility into supply chain activities to support buying decisions		Minimized distribution cycle times	Complete, accurate view of supply chain performance history to support business decisions
			Minimized exception processing	
	Perfect Order Index	Optimized communication to vendors and other supply chain stakeholders	Perfect Order Index	Perfect Order Index

Vendor Compliance Optimization Processes

A best-in-class Vendor Compliance Optimization solution enables retailers to implement four supply chain processes that are essential for deriving maximum value from vendor compliance:

- Vendor Compliance System - The software, hardware, and database infrastructure that will support vendor compliance activities.
- Vendor Compliance Workflow - The integration of human activities with the Vendor Compliance System that will execute the Vendor Compliance program.
- Retail Supply Chain Collaboration - The communication, planning, and cooperative activities that facilitate optimal execution of the supply chain.
- Retail Continuous Improvement - The leveraging of the supply chain performance data captured and produced by vendor compliance optimization activities, to enable the enterprise to identify supply chain execution failures and successes and adjust merchandising and other supply chain planning and execution.

The Best-In-Class Vendor Compliance Processes diagram (Diagram 1, below left) illustrates the relationships between the four processes. The light blue boxes describe specific interaction between the processes and the arrows indicate the flow of information between the processes.

The Vendor Compliance Optimization Roadmaps table (Table 3, below right) illustrates the phases of each process. These phases are applied to implementation of each process and ongoing activities that take place after each process is up and running.
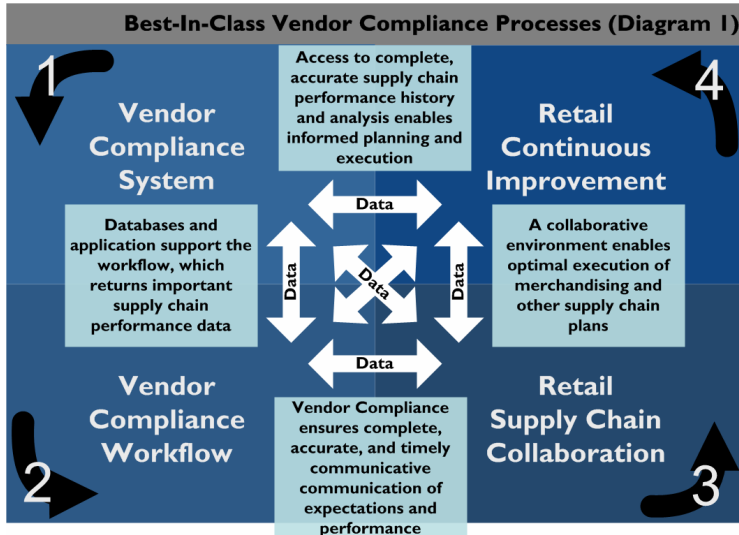
> "Companies that adopt best-in-class supplier performance management practices are two to three times as likely to achieve supplier on-time delivery and first-time fill rates that are above the market average."
>
> Beth Enslow
> Vice-President, Enterprise Research, Aberdeen Group

Best-In-Class Vendor Compliance Processes (Diagram 1)

1. **Vendor Compliance System** — Databases and application support the workflow, which returns important supply chain performance data

Access to complete, accurate supply chain performance history and analysis enables informed planning and execution

4. **Retail Continuous Improvement** — A collaborative environment enables optimal execution of merchandising and other supply chain plans

2. **Vendor Compliance Workflow**

Vendor Compliance ensures complete, accurate, and timely communicative communication of expectations and performance

3. **Retail Supply Chain Collaboration**

(Data flows between processes)

Vendor Compliance Optimization Roadmaps (Table 3)

Vendor Compliance System Roadmap (Process 1)				
Step I	Step II	Step III	Step IV	Step V
Gather supply chain data	Process and analyze supply chain data	Assess vendor performance	Convert violations to charges	Communicate performance data to stakeholders

Vendor Compliance Workflow Roadmap (Process 2)				
Step I	Step II	Step III	Step IV	Step V
Publish rules and routing guide to stakeholders	Vendors fulfill orders	Audit vendor activities	Create and communicate charges	Vendor compliance optimization

Retail Supply Chain Collaboration Roadmap (Process 3)				
Step I	Step II	Step III	Step IV	Step V
Identify supply chain stakeholders	Develop supply chain objectives and expectations	Develop internal stakeholder communication	Develop external stakeholder communication	Leverage accountability, visibility, and predictability

Retail Continuous Improvement Roadmap (Process 4)				
Step I	Step II	Step III	Step IV	Step V
Plan	Prepare	Execute plans and check performance	Implement supply chain collaboration	Adjust plans and repeat process

Objectives and Standards

To be effective the vendor compliance program must support corporate objectives and must facilitate existing supply chain processes.

The first step is to develop supply chain objectives that support corporate objectives (as indicated in Table 4, right). Develop supply chain stakeholder performance expectations based on the supply chain objectives and consideration of the retailer's logistics and distribution environment.

Understanding how product is shipped, processed in the distribution center, and merchandised in the store is essential for developing supply chain expectations and performance standards. The compliance program should be built to facilitate a smooth and continually-improving flow of merchandise through the distribution center. The SMART Examples table (Table 5, right) indicates some of the items to consider when developing supply chain expectations and performance standards.

The next step is to translate the supply chain stakeholder expectations into performance standards. It is essential that data is available to support measurement of performance standards. Follow the SMART criteria to provide the stakeholders with the best possible opportunity to meet these standards. The SMART Supply Chain Standards (Table 6, right) applies the SMART method to supply chain performance standards.

Once performance standards have been defined, they must be clearly communicated to the vendors or suppliers, and other supply chain stakeholders. Most often, retailers pass these standards or "compliance rules" to vendors via a combination of routing, logistics guides, or purchase order contracts. It is essential that vendors and other supply chain stakeholders are thoroughly educated on the intent and importance of the standards and how they will be enforced.

The Importance of Data

The data must be current, complete, accurate, and readily accessible. It is essential to develop efficient methods for collecting supply chain performance data. The best method is to consolidate the data in a Supply Chain Data Warehouse. Sources of data that support supply chain performance measurement include purchase orders, items, EDI/ASN, freight, receipts, RF and manual audits, and AP data. Other software and hardware considerations include:

- PC-based database and spreadsheet software is acceptable for small retailers managing a small number of rules.
- Larger retailers, or those managing more than a few rules, require a robust database, such as Oracle.
- All the data must be stored in one location, to ensure that all stakeholders reference the same data.

- A robust database requires a user-friendly front-end application to facilitate data entry and analysis.
- What data will be gathered systemically from existing legacy systems versus human intervention?
- Where will entered data be collected? The receiving dock, vendor compliance office, or transportation office?
- Can existing processes and staff gather the data, or are new systems and staff required?
- Will the system be paper-based, RF-based, or both?

> "Over the longer term, those companies and supply chains that learn how to maximize the use of information to get optimal performance from the other drivers will gain the most market share and be the most profitable."
>
> Michael Hugo, *Essentials of Supply Chain Management*, Page 36
> (Wiley, March 2006)
>
> Vice-President, Enterprise Research, Aberdeen Group

Alignment of Supply Chain Objectives (Table 4)

Standard	The Retail Enterprise	Retail Merchants	Vendor	Distribution	Stores
Bulk or Store Pack	Maximize sales	Optimize vendor-to-sales floor cycle	Increased revenue and product flow	Optimized flow	Optimal selling opportunities
BOL Standards	Cost reduction	Optimize distribution cycle	Increased revenue and product flow	Optimized flow	Optimal selling opportunities
MSRP Pre-Ticketing	Cost reduction	Reduce costs and optimize flow	Increased revenue and product flow	Cost reduction and optimized flow	Cost reduction
Carton Labelling	Cost reduction	Reduce costs and optimize flow	Product flow to sales floor	Optimized flow	Optimal selling opportunities
Advance Shipment Notification	Cost reduction	Optimize trouble resolution and flow	Product flow to sales floor	Planned receiving	Optimal selling opportunities
Value-Added Services	Cost reduction	Optimize flexibility	Increased revenue and product flow	Cost reduction and optimized flow	Cost reduction
Shipment Frequency	Cost reduction	Reduce costs and optimize execution	Leverage optimal selling period	Cost reduction and efficient flow	Optimal selling opportunities
On-Time Delivery	Maximize sales	Merchandising plan execution	Leverage optimal selling period	Minimized troubles and optimized flow	Optimal selling opportunities
PO Fill-Rates	Maximize sales	Merchandising plan execution	Leverage optimal selling period	Minimized troubles and optimized flow	Optimal selling opportunities
ASN Accuracy	Maximize sales	Merchandising plan execution	Product flow to sales floor	Minimized troubles and optimized flow	Minimize trouble shipments

SMART Examples (partial list - Table 5)

	ASN Accuracy	On-Time Delivery	PO Fill Rate	UCC-128 Compliance	Floor-Ready Compliance
Specific What? Why? Where? When?	Carton contents do not match ASN	PO delivered between start and end dates	PO items filled within an over/under tolerance	UCC-128 carton label must match ASN	UPC ticket must include human-readable data
Measurable To enable detection and enforcement	Automated comparison of RF carton audit to ASN	Automated comparison of delivery data to PO	Automated comparison of receipts to PO	Automated comparison of RF carton label audit to ASN	Manual audit of human-readable information on ticket
Actionable To ensure relevance and credibility	Improving ASN accuracy justifies audit costs	Improving on-time performance justifies audit costs	Improving PO fill rate justifies audit costs	Improving UCC-128 performance justifies audit costs	Ensuring accurate UPC tickets justifies audit costs
Reasonable To encourage cooperation from vendors	Most vendors are readily able to comply	Most vendors are readily able to comply	Most vendors are readily able to comply	Most vendors are readily able to comply	Most vendors are readily able to comply
Timely To ensure rapid benefits	Performance can be captured and shared quickly	Performance can be captured and shared quickly	Performance can be captured and shared quickly	Performance can be captured and shared quickly	Performance can be captured and shared quickly

SMART Supply Chain Standards (Table 6)

Standard	Specific	Measurable	Actionable	Realistic	Timely
Bulk or Store Pack	Bulk pack or store pack?	Receiving audit	Vendor corrects future shipments	Determine for each vendor/order	Rapid detection and notification
BOL Standards	BOL contains X information?	Traffic audit	Vendor corrects future documents	Determine for each vendor/order	Rapid detection and notification
MSRP Pre-Ticketing	MSRP contains X information?	Receiving audit	Vendor corrects future shipments	Determine for each vendor/order	Rapid detection and notification
Carton Labelling	Cartons displays X information?	Receiving audit	Vendor corrects future shipments	Determine for each vendor/order	Rapid detection and notification
Advance Shipment Notification	ASN complies with retailer format?	Automated detection	Vendor corrects future ASNs	Determine for each vendor/order	Rapid detection and notification
Value-Added Services	Vendor correctly ticketed merchandise?	Receiving audit	Vendor corrects future shipments	Determine for each vendor/order	Rapid detection and notification
Shipment Frequency	No more than X shipments per PO	Automated detection	Vendor corrects future PO shipments	Determine for each vendor/order	Rapid detection and notification
On-Time Delivery	PO arrived on-time?	Automated detection	Vendor ships future shipments on time	Determine for each vendor/order	Rapid detection and notification
PO Fill-Rates	PO fill-rate is above or below specific %	Automated detection	Vendor achieves fill-rate in the future	Determine for each vendor/order	Rapid detection and notification
ASN Accuracy	ASN must match PO and shipment	Automated detection and manual audits	Vendor corrects future ASNs	Determine for each vendor/order	Rapid detection and notification

ComplianceNetworks

Measure results

An Aberdeen Group supply chain study in November 2002 found that nearly 60% of enterprises are less than satisfied with their ability to consistently measure and manage supplier performance. Further, the study found that the typical supplier performance measurement program targets less than a third of the total supply base. A best-in-class Vendor Compliance program will target 100% of vendors in order to maximize collaboration among supply chain stakeholders and optimize the benefits to the enterprise.

Automated Performance Measurement (Table 7)
Capture performance data
Compare performance to expectations
Detect performance failures
Defend detection with accurate, complete, and objective evidence
Document failures and evidence
Assess the costs of failures and commensurate expense offset penalties or chargebacks
Communicate performance and evidence

The 100% supplier target is more easily achieved if the vendor compliance program leverages automated systems to perform as much of the performance-measuring activities as possible. This enables humans to do what they do best (analyze, evaluate, perform manual audits, and data entry). The Automated Performance Measurement table (Table 7, left) indicates compliance activities that are good candidates for automation.

Outcomes of an Effective Vendor Compliance Program (Diagram 2, right).

The gray bands indicate three general levels of compliance programs. The blue pyramid on the left, labeled Retailer Community Adoption, indicates the universe of retailers with compliance programs. The relative number of retailers is indicated by the size of each blue section. The upside-down pyramid in the middle, labeled Relative Benefits, indicates the return that retailers gain from compliance programs at each level. The relative benefits are indicated by the size of each blue section. The triangle on the right, labeled Relative Effort, indicates the human resource cost to execute vendor compliance programs at each level. The arrow on the right indicates the collaborative value for supply chain stakeholders that can be realized as more capable and robust compliance programs are implemented.

Vendor Compliance Outcomes Hierarchy (Diagram 2)
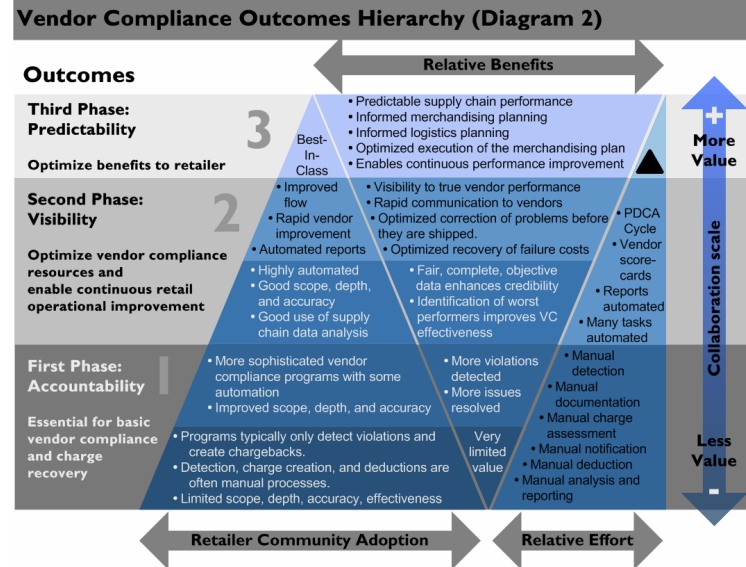
Accountability

Good vendor compliance programs hold vendors accountable when they fail to follow the rules, as determined by accurate, complete, and fair detection and defense of failures. For each objective or rule, monetary penalties that are commensurate with the cost of correcting rules violations and other costs to the retailer (lost sales, for example). The intent of these penalties is to optimize and improve supply chain execution of the merchandising plan, not to create revenue. Accountability is best supported when software processes are written to detect sub-standard performance by reviewing and comparing transactions to expectations. Manual detection of violations is less accurate, less complete, and more costly than automated detection.

Visibility

Vendor compliance programs that provide visibility to supply chain activities allow the retailer to leverage valuable data to make better-informed supply chain decisions. Objective information is always more helpful for making sound, accurate decisions, as opposed to assumptions or subjective information, which is often skewed by normal human bias or presupposed notions that are often perpetuated by bureaucracies, but are not based in fact. Failures must be automatically e-mailed or otherwise made available to appropriate stakeholders, who must assess their performance relative to supply chain expectations and make operational adjustments necessary for improvement. Photos and images provide undeniable proof and facilitate behavioral change.

Predictability

Predictability enables the retailer to optimize supply execution of the merchandising plan and by doing so gain the highest probability of achieving business goals. Effective analysis of accurate historical supply chain performance data enables the retailer to base the merchandising plan on facts as opposed to myth. Predictability is achieved by analyzing historical vendor performance in order to anticipate future vendor performance. Predictability is leveraged by making adjustments to orders by increasing or decreasing the quantity of items ordered based on historical vendor shortages and overages, respectively, and by ordering sooner or later, based on historical vendor late or early shipping habits. This enables the retailer to benefit from the supply chain data warehouse in the short term, while managing longer term behavioral change.

> **"…**we stand fast on our contention that companies can add as much as 8 points of new profit to a financial statement through supply chain improvements.**"**
>
> Supply Chain Management Review, January 1, 2006

Profiting from Vendor Compliance Optimization in the Retail Supply Chain

A competent compliance program integrated with a comprehensive supply chain data warehouse becomes a powerful tool for improvement of supply chain planning and execution. It enables the retailer to manage and recover the cost of vendor shipping problems. It provides historical data with which to anticipate vendor behavior, address problem behavior before it happens and adjust ordering decisions.

About Compliance Networks, LLC

Compliance Networks delivers retail supply chain solutions that enable retailers to align their vendor community with the strategic goals of the retail enterprise to systematically eliminate costs and improve profitability. The result is consistent, predictable, and more profitable supply chains. Headquartered in Sugar Land, Texas, Compliance Networks also maintains an additional office in Little Rock, Arkansas. Compliance Networks' customer base includes leading retail organizations such as Kohls, Burlington Coat Factory, Pep Boys, The Sports Authority, Elder-Beerman/Bon-Ton Stores Corporation and Gottschalks Stores. For more information, visit www.compliancenetworks.com.