

CASE STUDY FOR RETAIL INDUSTRY

Overview

Improve profitability and cash flow by managing on-contract supplier spend and achieving a total lower cost of goods

Management at Detski Mir, Russia's largest and leading children's goods retailer with 39 stores across the country, have pursued an aggressive expansion strategy that has meant increasing their supplier relationship management and supply chain capabilities.

One of the key areas that management has recognized as vital to improving their competitive position in the Russian market, is its contract lifecycle practices for managing supplier purchasing agreements.

With an improved ability to both manage and execute purchasing contracts, management expects to lower its Cost of Goods Sold by up to 7% on overall turnover.

Organization Profile

Detski Mir, a famous Russian national institution since Soviet times, is the country's largest and leading children's goods retailer with 39 stores in different formats across the CIS.

Business Situation

Detski Mir is undertaking an aggressive expansion plan by increasing the number of outlets and store formats that will nearly double its sales and purchasing requirements over the next 12-16 months.

Improving its supply chain management capabilities to support its growth plans are recognized as a key factor in the overall plan's success.

Business Situation

Detski Mir is headquartered in Moscow and has national coverage with currently 39 stores across Russia and the CIS.

Growth and expansion plans

- ◆ Supplier base to increase by 1/3 with a mix of international brands and importers-distributors; plans for private label
- ◆ Aggressive plans for expansion in number of stores, locations, format types and product range

Product range management

- ◆ Wide product assortment of children's goods, from toys to furniture to clothing and food-cosmetic products
- ◆ Centralized product range management for dealing with supplier catalogs, data maintenance and IT systems

Sourcing and Procurement

- ◆ Centralized buying and goods receipt for main Distribution center and re-distribution to stores
- ◆ On-contract purchasing with most suppliers; long term discount and incentive based contracts managed manually
- ◆ Limited spend reporting, forecasting and contract rebate calculation;
- ◆ Ad-hoc contract management flow at operational level, across departments and roles (i.e. Purchasing and Finance departments)

Priorities: Contract Management

The Commercial Team have highlighted the very limited supplier contract management capabilities and its impact on the Detski Mir business operations and costs:

Contract terms and conditions: most or all suppliers have long term contracts that include discounts, rebates, marketing allowances and promotions. However, improving the current contract terms to include incentives and rewards that would provide deeper discounting on volume purchases and a lower Cost of Goods, including the following:

- ◆ Volume Growth rebates based on achieving tiered reward targets
- ◆ Category and product related retro bonuses, based on targets that increase supplier brand market share
- ◆ Supplier performance fees (see below)
- ◆ Improved listing fees to account for products listed by organisational unit
- ◆ Promotional-marketing campaigns

Supplier performance: suppliers commonly short-ship on an accepted Purchase Order, causing lost sales and revenues, and short shipments can vary up to 40% of the goods ordered, causing serious loss of sales due to empty shelves.

Cash flow: rebate collection occurs once a year as its a time consuming and resource dependant activity to calculate supplier claim backs. With an automated claims generation process claim backs could be issued quarterly or monthly, thereby strengthening overall cash flow.

Security: the lack of need for role based permissions to restrict user access to information on suppliers, contracts and other sensitive information is noted as a key requirement in order to protect the company's information related assets

Rogue purchasing: with unlimited access to information, poor process visibility by the head of the Commercial Department and the ability for category-purchasing managers to write up their own Purchase Orders without approval, this creates an opportunity for employee fraud when ordering from suppliers.

Payment controls: there is no automated price verification between the contract price for goods listed by a supplier and the invoice price for the same products that a supplier charges Detski Mir. With no price verification, the Commercial Director has a strong belief that there are significant supplier overcharges that are accepted by the Finance Department when settling and paying invoices, especially as all incentive calculations are currently manual and highly error prone.

Lack of purchase price management and true cost visibility : suppliers have deliberately used incentives and rebates to make their pricing policies less visible and more difficult to compare in the marketplace

Limited negotiation capabilities: an inability to track spend by product and supplier as well as measuring supplier performance means limited negotiation capabilities on contracts

Purchase incentive tracking: the lack of ability to track supplier contract spend, as well as no forecasting, making it difficult for buyers to perform on many of the new negotiated time and volume based rewards

Solution

Csycom introduced at Detski Mir its **Contract Spend Management** solution to manage the contract lifecycle and on-contract purchasing activities.

By monitoring, managing and forecasting Detski Mir's spend against supplier agreements, the Contract Spend Management solution provided a lower cost-of- goods, improved financial and purchase planning, increased cash flow and improved profitability and ensured that Detski Mir received the rewards, rebates and discounts to which they were entitled.

Contract Spend Management tackled the three key areas of the effective purchase of goods and services.

- ◆ **Contract Definition** - ensured that the commercial terms of all agreements were understood, defined, documented, stored & retrievable.
- ◆ **Spend Forecasting** - ensured that the anticipated values and volumes were reflected in the terms of the contract; that realistic price break-points and incentives were in place; and that forecasts projected spend against contractual commitments and rebates.
- ◆ **Compliance Measurement** - ensured that spend performance is measured against contract so that every penny earned through incentives for each product and programme was claimed

Pilot Project

The Contract Spend Management solution was first tested on live transactional data over a number of supplier contracts in order to get an accurate assessment of the potential savings over a 12 month period:

Projected annual savings based on tested averages

Overcharges + Short shipment fees= \$6.8M

Cash flow savings (1 month collection vs 12 month collection period, interest rate 8% annual) = \$ 1.04M

Rewards collection \$24.18M X 10% (estimated manual calculation errors & oversight) = \$ 2.24 M

Total Potential Savings = \$10.08M

Future savings and benefits

- ◆ Estimated additional 1% savings from improved contract terms and conditions added to system (e.g. Supplier Brand growth reward, Supplier marketing fees by store unit, shelf space allocation etc)
- ◆ True cost analysis: net net net cost by product after all rewards, discounts and fees are applied
- ◆ Lower purchase cost: better negotiation capabilities with true cost and margin analysis
- ◆ ROI visibility: cost price and gross profit analysis over time, by supplier and product
- ◆ Range rationalization via flying/dying product analysis

Business Benefits

Financial intelligence

Improved the bottom line by identifying:

- ◆ Incorrectly priced invoices
- ◆ Missed discounts
- ◆ Missed rebates

Cost optimisation

Improved performance by delivering:

- ◆ Accurate rebate accruals
- ◆ Better spend information for improved contract renegotiation
- ◆ Notification of approaching incentive, discount and rebate triggers

Supply chain management

Improved business methodologies:

- ◆ Spend analysis by any group of products
- ◆ True Cost Analysis and verification
- ◆ Supplier performance management

Deployment

Post-pilot, Detski Mir approved the deployment of the Contract Spend Management solution to be rolled out for the new fiscal year starting in Q1 2008.

By managing over 500 supplier contracts and over \$600M spend, the commercial department expects the solution will provide significant improvement in the way contracts are executed and purchasing activities are managed .

Not only will Detski Mir benefit from a significant reduction in the cost of goods sold, but it will be able to pursue its aggressive expansion strategy with the knowledge that its spend activities are being efficiently managed.