Unlocking the potential of Not-For-Resale Procurement in Retail

Increasing retail profit margins by 70 basis points through professional NFR procurement

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Introduction

Over the last few years, KPMG have supported leading retailers in reducing their procurement costs in both ‘For Resale’ and ‘Not For Resale’ spend, all over the world.

During these engagements, we noticed that retailers were putting limited emphasis on buying Not For Resale spend professionally, despite it accounting for 8–14% of the total cost base. We also noticed that all retailers faced challenges in implementing the right sourcing strategies for Not For Resale products across international operations. Most discussions focused on whether a product or service was being bought globally/regionally or locally. As a result, most of the retailers were ‘stuck in the middle’ and NFR procurement was not delivering the value necessary to remain competitive.

Based on a number of different KPMG engagements, and research conducted on 25 International Global Grocery Retailers, this document provides an insight into how retailers can increase their profit margin (by 70 basis points) through professional Not-For-Resale Procurement.

For more information on anything in this guide, or if you’d like to talk more about how NFR Procurement could help your business, please contact:

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Preface

1 Why global retailers can no longer afford to neglect NFR procurement

For any retailer, the cost of the goods they purchase can amount to between 60% and 85% of their total turnover and, largely due to the globalisation of supply networks (ICT, Finance, Cleaning etc.), this proportion has been steadily rising for the last 20 years. Procurement, therefore, offers tremendous scope for cost reduction and has witnessed a significant increase in management attention and resource allocation as a result.

For the most part, this increase applies to direct procurement (goods used in end products). Indirect procurement (goods used in support processes) is smaller in volume and currently receives far less attention. This holds especially true in Retail, where indirect procurement involves all products that are not sold to customers. **KPMG's global Retail projects show that indirect purchasing has the potential to decrease total costs by 1% (NFR costs by 5.1%), and increase profit margins by as much as 70 basis points**. This guide aims to demonstrate exactly how this can be done.

Unlocking the potential of indirect procurement requires significant effort and is a complex transformation that may take up to two years. Many global retailers are yet to succeed in exploiting the benefits.[1] However, the causes of these missed opportunities are known, as are the steps required to overcome them. This white paper focuses on indirect procurement in the Retail sector (often called Not For Resale (NFR) procurement) and compares current Retail practices with those of best-in-class procurement organizations. It calculates the potential of NFR procurement and details how to realize the benefits. The approach described is based on KPMG's experience with the world's largest retailers and has been tested and improved in our global practices over the past decades.

The costs of headquarters and store operations account for up to 25% of the total costs of a retailer, and employee costs are the largest contributor. As a result, companies are now starting to invest in more automation and digitalization. For instance, self-checkout machines, self-scanners, mobile phones, facial recognition sensors and Wi-Fi tracking are increasingly being used to replace cash registers.[2] Robots have also been deployed to clean stores during the night,[3] and electronic price tags are being used to reduce the costs of managing price changes. As a result, employee costs have declined and the spend on goods Not For Resale has increased. As this trend continues to evolve, indirect procurement will become ever more important.

Note: (1) Research methodology explained on page XX.
(2) Amazon GO launched a new concept store in October 2017 in Seattle.
(3) A Dutch retailer deployed robots for cleaning purposes in stores in 2017..

The challenge

2 Retailers are facing increasing margin pressure

Retail is a highly competitive sector with slender operating profit margins. Retailers have seen margin pressure steadily increase as a result of two main trends in consumer behaviour:

- **Consumers are increasingly buying online.** Retailers report that 19% of their sales are no longer purchased in physical stores and they expect this share to increase to 27% by 2020. Operating two channels simultaneously (in store and online) poses additional challenges and costs. Consumers expecting their deliveries to be faster, and free, only adds to this pressure.
- **Consumers are changing their attitude towards discounters**. Discounters not only manage to attract more consumers, but they also retain them as loyal customers. Full service retailers are losing clients, and 35% of retail executives now believe that the advent of new competitors with disruptive models is going to be the most challenging market trend for them over the next two years.

As a result, **the average operating profit margin in Retail is now just 3%**. With increasing competition globally due to discounters and online shopping, retailers must improve operating profit margins in order to sustain potential price wars and keep shareholders satisfied. By increasing the operating profit margin, retailers can create the flexibility to reduce prices and stay competitive.

Top 10 retailers, 2016

Rank	
1. Wal-mart Stores, Inc.	2.9%
2. Costo Wholesale Corporation	2.0%
3. The Kroger Co.	1.7%
4. Schwarz Group	n/a
5. Walgreens Boots Alliance, Inc.	3.6%
6. Amazon.com, Inc.	1.7%
7. The Home Depot Inc.	8.4%
8. Aldi Group	n/a
9. Carrefour S.A.	1.1%
10. CVS Health Corporation	3.0%

Average top 10

Figure 1: Profit margins of large Retailers

Note: (4) KPMG 2016 Global Consumer Executive Top of Mind Survey.
(5) KPMG Annual Retail Survey 2018: What consumers are telling us about how they shop.

3 Global Retailers trail behind best-in-class NFR procurement organizations

Highly competitive markets and small margins within the Retail industry mean retailers need to transform their NFR procurement. In addition, the high volumes of products to be transported via supply chains across a large geographic area force retailers to strongly optimize and standardize their processes. On top of that, customers continue to move towards online shopping. As a result, **retailers that have not optimized their processes down to the smallest detail are rapidly losing their competitive edge over top performers.**

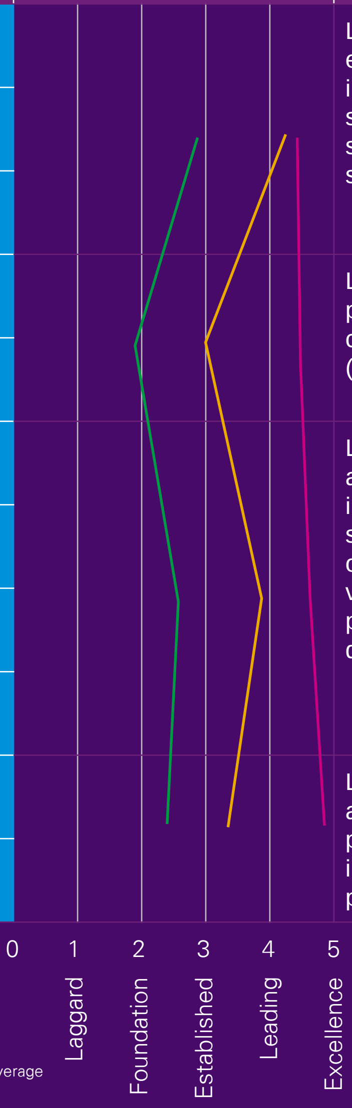
The global versus local debate

Global retailers either have one global brand, or run a number of local banners. Retailers with one global brand focus on introducing a single store format in every market (e.g. Aldi, Lidl). Global Retailers with local banners run different brands that operate in a smaller region or country where brand recognition is high (e.g. Ahold Delhaize and Walmart). Local banners do not use the name and logo of the global retailer. Within such a structure, retailers often face the challenge of successfully implementing strategies that are shared and executed by all local banners. This challenge has become even more difficult to address as **retailers are scaling up through mergers and acquisitions, while retail demand is still locally oriented.**

Due to the variety in local demand and the influence of transportation costs on the overall cost of NFR, **retailers have often focused on local sourcing, failing to find an optimal balance with global sourcing in order to ensure optimization of profit margins**. Optimizing NFR procurement with the right balance between local and global sourcing requires a high level of data insight and understanding of local and global markets. As large global retailers often have a history of mergers and acquisitions, obtaining this level of insight across all local banners can be challenging. After resources, what's really required is the right tooling. However, **underinvestment in tooling is common among larger retailers, resulting in less visibility and control of spend**.

Best-in-class global retailers gain significant competitive advantage from their NFR procurement compared to average performing retailers. In each of the four cluster dimensions we use — strategy, organization, processes and enablers — a number of characteristics set apart the scores. The graph below shows the current maturity of global retailers in each of these dimensions. The industry average is well below the best-in-class global retailers' maturity, with the largest difference being in the processes domain. Best-in-class global Retailers are still not as mature as best-in-class procurement organizations across industries, lacking especially in enablers, processes and organization, to achieve the highest value out of NFR.

Cluster	Dimensions	Comparison	Details
Strategy	Strategy & Change Management		Leading procurement organizations are value engineering the whole supply chain. This includes tax engineering. They have standardized, brand in dependent product and services such as meat trays, packaging, shelving, copy paper, etc.
	Regulation & Compliance		
	Governance & Controls		
Organization	Structure		Leading procurement organizations balance products and services sourced locally and combined, while including all cost drivers (transport, packaging, etc.)
	People		
Processes	Category Management Cycle		Leading retail organizations have implemented a harmonized sourcing process and have insight into spend and contracts of first and second tier suppliers. Leading procurement organizations use web crawlers and integrated value modelling to monitor supplier performance and the impact of market developments on the prices of their products.
	Source to Contract		
	Operational Processes		
	Supplier Lifecycle Management		
Enablers	Systems & Technology		Leading procurement organizations have tools and systems available to run procurement processes effectively and to provide insight into the data needed do make the right procurement decisions.
	Master Data & BI-PI		



Key: 🟥 Best in class x-industry 🟨 Best in class retail 🟩 Industry average

Source: Research methodology explained on page 15.

The solution

4 NFR procurement presents an opportunity to protect margins and fund change

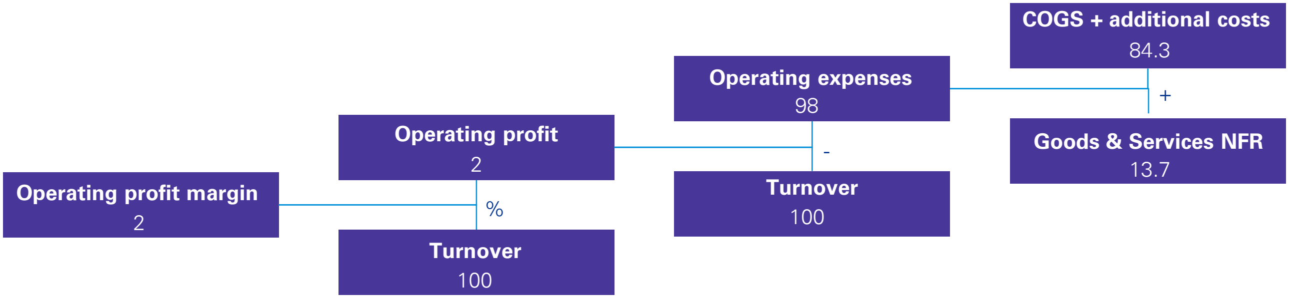
The costs of goods & services Not For Resale (NFR) currently account for 8 –14% of the total cost base of a retailer. However, the proportion of the cost base generally depends on the type of formats operated by the retailer. For example, discounters have a different format compared to full service retailers and therefore have a different NFR cost percentage.

Also, the proportion of spend on NFR depends on the degree to which processes are outsourced. For example, outsourcing cleaning services results in a higher NFR spend compared to performing these services in-house. The figure below shows the typical NFR procurement categories found within Retail.

NFR categories

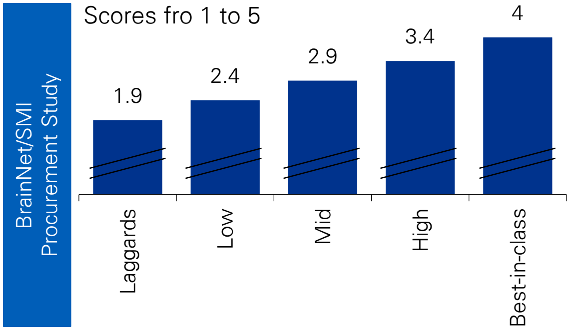
Reducing costs is a faster and more effective way of improving margins than increasing sales volumes. By focusing on elements of the total cost base, any company can increase its profit margin significantly. This holds true for both GFR (goods for resale) and NFR procurement. The latter, however, is usually overlooked or overshadowed by a focus on GFR, resulting in a lower procurement maturity. NFR procurement, therefore, presents a large opportunity to reduce costs and improve margins.

Optimizing the right processes within NFR procurement will enable a retailer to increase its operating profit margin by 40 to 70 basis points. To illustrate this, consider an example. The DuPont matrix below shows how the operating profit margin is calculated for a Retailer with 14% NFR spend.

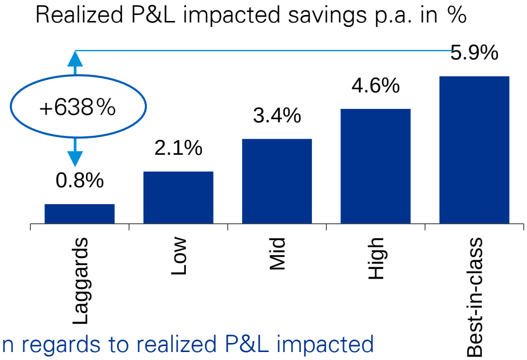


The retailer, in this example, does not have a mature procurement organization for NFR purchasing. It has the lowest maturity score of 'laggard'. KPMG research shows that retailers with a best-in-class NFR procurement team realise 5.9% in savings, compared to only 0.8% for laggards. Therefore, a laggard has the opportunity to reduce its NFR costs by 5.1% by applying best-in-class NFR procurement techniques.

The maturity level of procurement …



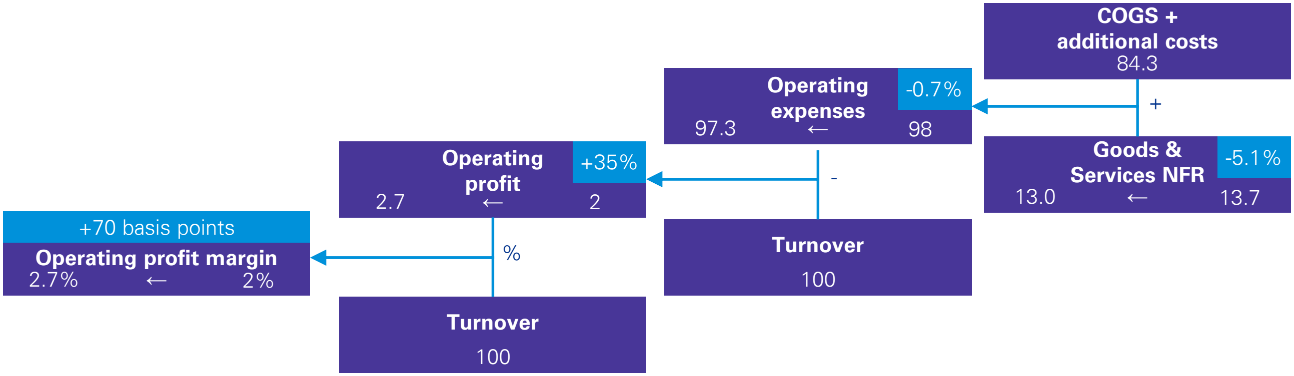
… is directly correlated to realized savings.



Best-in-class procurement organizations outperform their peers by up to 638% in regards to realized P&L impacted annual procurement savings on indirect spend/Not For Resale.

Source: Research methodology explained on page 15.

The next DuPont matrix shows how the same retailer's operation margin changes when its procurement maturity improves to best-in-class. The operating margin rises from 2.0% to 2.7% — an increase of 70 basis points.



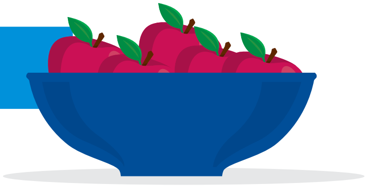
To put this into perspective, an equal increase in operating profit attained based solely on turnover increase, would require turnover increase of 35%[6].

Note: (6) Assuming all costs are marginal costs.

Chart the path

5 A comprehensive roadmap can help to establish leading procurement functions

The roadmap proposed in this guide is based on the four dimensions routinely used by KPMG to establish leading procurement functions – strategy, organization, processes and enablers.



Strategy

Often we notice that NFR departments lack a strategy and clear accountability. Frequently, we see that more than one employee is buying NFR products or services, whilst only one department or person within the company is buying Goods for Resale.Therefore, every retailer has to establish the right responsibility and accountability.

KPMG believes that NFR departments need to be responsible for the sourcing of all NFR products and services used by a retailer, including packaging. Within this scope, NFR should have a laser focus on value creation, e.g. focusing not on price but on optimizing the total costs of ownership to a retailer, and managing its supply and demand risks.

This accountability should also extend to a center of excellence for packaging, which would also manage packaging used in other areas, such as private label. As packaging often constitutes a large, hidden source of NFR, as well as an increasing environmental concern, it's vital that global retailers start to consider this oft neglected area.

Organization

International retailers are constantly challenging the structure of their organizations, shifting between centralized models (to benefit from the buying power of the group) and de-centralized models (to optimize local flexibility). Some more sophisticated models even combine these two strategies. However, all these approaches are old-fashioned and mean that many companies are now stuck somewhere in the middle when it comes to NFR procurement.

An effective international professional NFR procurement department can only be achieved when a retailer implements a hybrid organizational structure. This consists of both local/decentralized and centralized procurement teams, all operating as one. According to Dr. Fons Trompenaars' concept of dilemma reconciliation,[7] local/decentralized teams must adopt sourcing strategies that "buy locally by making use of the buying power of the group", whilst centralized teams adopt sourcing strategies that "buy globally but provide flexibility locally".

This reconciliation ensures the bottom line (and the supply-base risks of a retailer) is optimized, both locally and globally. In addition, lower value activities like managing catalogues and operational buying processes are identified and analyzed to decide whether they will be automated, offshored or outsourced.

From an employee point of view, procurement managers who have a 'can-do and co-operative' attitude towards the business should be selected. Whilst procurement managers are value engineers and need to be experts in their field of operations, they should also rotate frequently among other business functions.

Note: (7) Fons Trompenaars and Charles Hampden-Turner, Riding the Waves of Culture: Understanding Diversity in Global Business.

Processes

For all non-banner-specific businesses, a global plan of best practices is agreed and applied by the procurement team. This includes supply market characteristics, import tax legislations and supply risks. For OpCo/banner specific businesses, local category plans are agreed and applied, taking the overall strategy and buying power into consideration. Knowledge is shared over all banners/OpCos to ensure the best sourcing strategies are applied locally/globally.

Deep relationships are developed with key suppliers allowing them to deliver innovation and competitive advantage, for example sustainable packaging, ensuring supply or lowering energy costs.

Enablers

NFR procurement is enabled by a digital platform that provides a range of digital solutions that combine high automation, deep data insight and robust spend controls. For example:

- **A spend management solution** that provides real-time online insight into who has bought what, from which supplier, and against which commercial terms and order-to-pay process.
- **An e-sourcing solution** to ensure sourcing processes run effectively and enable procurement to touch the spend in the supply base frequently.
- **Effective tail management enabled by automation and catalogues**, so low-value transactions can be dealt with more efficiently.
- **A contract management solution** across countries to ensure everyone can see, follow and track the supplier with whom a contract has been concluded.
- **A supplier performance solution** so that global performance can be managed.
- **A procure-to-pay solution** across the organization that links business, finance and procurement effectively. As a result, supplier compliance (as well as control over cash) is optimized. In addition, invoice processing costs are minimized resulting in 95% reduction of administrative FTE.
- **A collaborative procurement strategy solution** that enables seamless cross-country category collaboration.
- **A 'should-cost' analysis solution** that enables procurement managers to calculate and predict the should-costs of products and services bought. This allows for fact-based negotiations and optimizes sourcing solutions, for example by replacing expensive ingredients with low-cost ingredients or sourcing in different countries to make use of wage differences.

Roadmap overview

a. NFR responsible for sourcing all NFR products/services

b. NFR owns center of excellence for packaging, along with packaging used in other areas like private label

c. NFR sources to specification/gives options to local brands to balance cost and brand 'localization'

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Strategy

a. Procurement managers with 'can-do and co-operative' attitude selected

b. Procurement managers should be experts in their field of operations

c. Procurement managers trained around a similar skillset for sourcing managers

d. Procurement managers rotate regularly with other business functions

02

Organization

a. For non-banner-specific categories, a global plan of best practices agreed and applied

b. For banner specific categories, local category plans agreed and applied

c. Knowledge shared over all banners

03

Processes

a. A spend management solution

b. An e-sourcing solution

c. A contract management solution

d. A supplier performance management solution

e. A procure-to-pay solution that links business, finance and procurement

f. A procurement strategy solution that enables cross-country category collaboration

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Enablers

If you'd like to see how your business could benefit, **talk to us today.**

Conclusion

In this paper, we've already seen how NFR presents a large opportunity for retailers to reduce costs and improve margins. So why are so many still businesses underestimating the value of NFR when, by simply putting it on the table, they could improve profits by up to a third?

In fact, NFR procurement optimization could reduce the NFR costs of the average Global Retailer by up to 5.1%, with the potential to improve profit margin up to 70 basis points. This improvement is equal to the profit margin increase that results from a 35% turnover increase, but requires significantly less time and resources.

At KPMG we think all retailers should be looking to harness this significant opportunity. That's why we've developed a proven roadmap for optimizing NFR procurement, which structures the required transformation and ensures success.

By rolling out workable sourcing strategies, hiring and training the right procurement professionals, ensuring processes are right for each section of the business and putting the correct digital solutions in place, we believe any Retail business can feel the benefit of optimized NFR.

About the research

This research is based on multiple engagements within the retail industry, and on the insights of 25 structured interviews that were held with different representatives of internationally operating Retailers spread over the world. All these representatives held senior positions within the procurement departments of their respective companies. In addition, the results of several KPMG projects within the relevant industries were triangulated with the outcomes of the interviews, and with the balance sheets of the respective clients – the result of which, is this paper.

Real - world examples

Case Study 1

Procurement integration proves the missing ingredient for leading global food retailers

In 2016-17, KPMG ran an NFR procurement integration project for a leading global food retailers based in Europe and the US. We were tasked with running the NFR integration and with taking responsibility for the NFR procurement unit.

The main objective was to realize synergy savings so that the client could uphold its promise to the shareholders. At the same time, our team was asked to set up a clear governance, reporting and organizational structure, supported by tooling and solutions.

KPMG organized a structured and rigorous process to realize the objectives of the retailer. All country managers for NFR procurement were engaged in strategy sessions to design the future procurement strategy of the new company, and these sessions were supported by organizational theorist Dr. Fons Trompenaars[8], to ensure cultural differences were taken into consideration.

At the same time, a new corporate procurement structure was implemented, supported by a rigorous category management process. Per category, Value Lever Workshops[9] were conducted to identify cost savings and obtain buy-in from category managers.

All workshops and savings initiatives were supported by enablers such as ‘should-cost’ tooling, ‘total cost of ownership (TCO) modelling’ and the recruitment of ‘subject matter experts’. Some examples of these savings initiatives included the buying process of plastic bags, magazines, prints, software, cooling machines, and transport. The results were impressive. Working together with KPMG, our client was able to realize more than three years of their committed target, within just one year.

Note: (8) Dr Fons Trompenaars is a Dutch-Grench organizational theorist, management consultant, and author in the field of cross-cultural communication. He is known for the development of Trompenaars’ model of national culture differences.

(9) The Value Lever Workshops are an integral part of the KPMG cost reduction methodology. The workshops focus on challenging stakeholders to identify saving opportunities across five value levers, the specifications of the products or service, insourcing vs. outsourcing, end-to-end process, supply markets and supplier agreements.

Case Study 2

UK food retailer transforms its NFR procurement to deliver £500m saving

Since 2016, KPMG has been supporting a leading food retailer based in the UK with their global NFR procurement transformation. Our client needed to transform procurement to help meet a £500m savings stretch target by 2020.

The first step was to utilize the client's proven tools to assess the maturity of the existing procurement function and understand where, and how, we could improve performance. We then helped design a future global operating model through leading collaborative design workshops with global procurement leaders and by providing leading insights into all aspects of the operating model (strategy, organization, processes and enablers).

Finally, we developed a roadmap detailing the projects that would be required to deliver the transformation, including:

- The introduction of a global process to optimize procurement across geographies, coupled with local focus to drive savings to the bottom line.
- The implementation of a new cloud-based source-to-pay system that combined high automation, deep data insight and robust spend controls.
- The development of a business partner model between procurement and the business stakeholders.
- Greater focus on value creation by ensuring lower value activity was automated, off-shored or outsourced.

KPMG guided the client through the technology selection process and we continue to support them in implementing parts of the new operating model. With some projects already completed successfully, the client is on track to deliver its £500m savings target.

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