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CHIEF SUPPLY CHAIN OFFICER™

INSIGHTS FOR TH… …XECUTIVE

Jim Patterson, VP, Global Operations, New Era

New Era Tips its Cap to a New Supply Chain

The 800-Pound Opportunity for Midsized Companies

Make IT Serve Your Bottom Line

Nothing but the Best for Best Buy's Supply Chain

Five Key Elements for Operations Excellence

The 800-Pound Opportunity

Dealing with multiple 800-pound gorillas is difficult for midsize companies. Here's how to turn that challenge into an 800-pound opportunity.

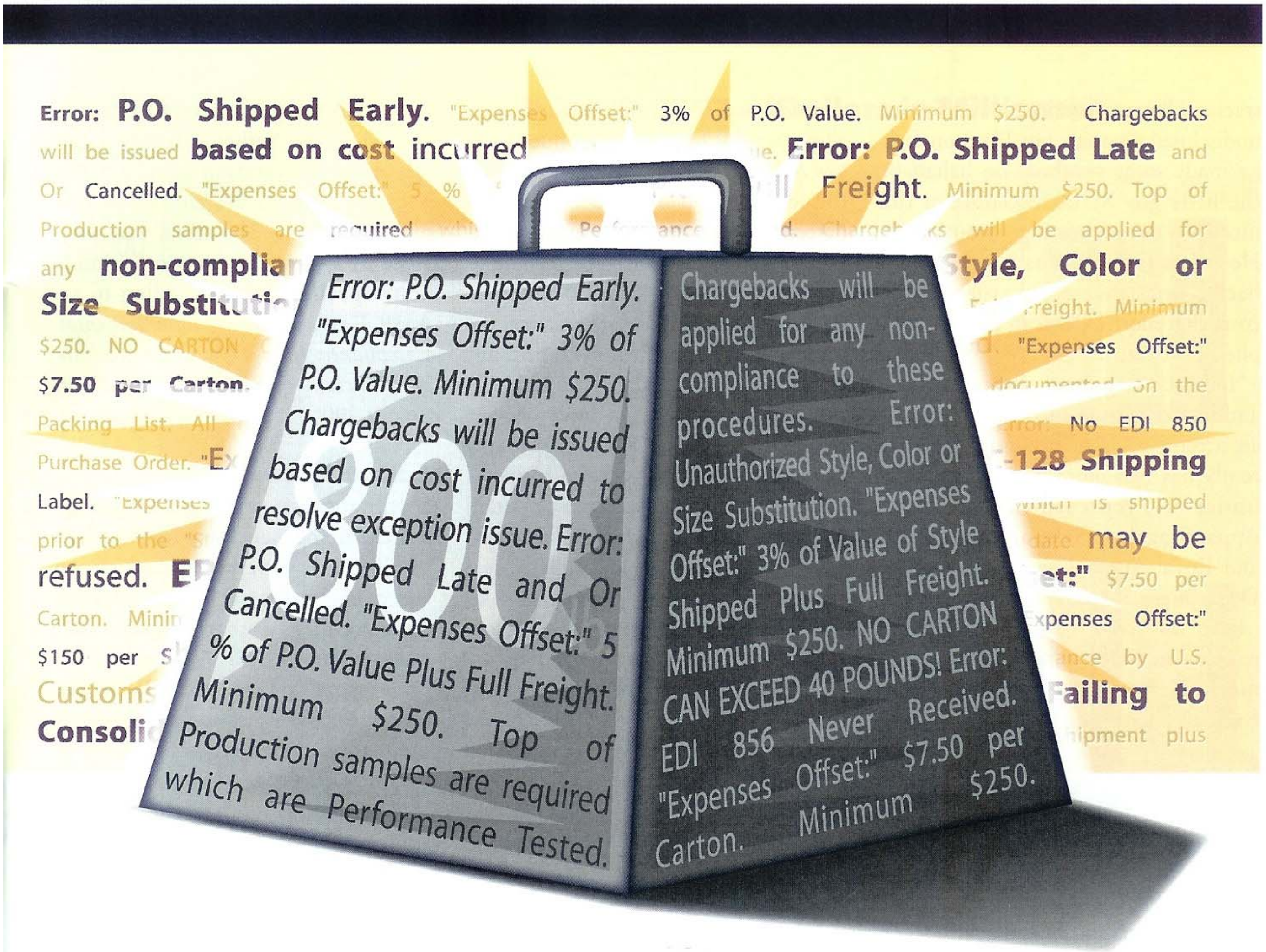
LISA TERRY

Flummoxed by the large number of chargebacks issued by a major retail customer for crushed boxes, which were amounting to tens of thousands of dollars, the supplier contacts the distribution center manager where the violations are occurring and asks to see a shipment unloaded. The DC manager agrees, and stands with the group watching the shipment being received as the retailer had specified in its vendor compliance manual, with boxes stacked floor to ceiling without pallets.

As they watch, the always-inventive DC workers unload the truck, creating a staircase out of the lower boxes to reach the upper ones, thereby subjecting each one to the crushing weight of a 200-lb. man. The DC manager's jaw drops, and the chargebacks—fines issued by supply chain masters to recoup the costs of bringing the shipment into compliance with its guidelines—are refunded.

Not all chargeback issues between trading partners work out that well, of course, but the incident illustrates the frustration suppliers can feel when faced with having to comply with the mandates of large customers. With the pressure increasing to tighten cycle times and trim costs in nearly every type of supply chain, many companies are mandating strict procedures to streamline processes. If you're a large operation, a so-called 800-pound gorilla, odds are you can impose those strictures on smaller upstream trading partners without too much pushback. If you're smaller, though, it can be much harder to streamline, because, as the lesser partner, you're expected to jump through hoops, not raise them.

Those pressures combined with a new regulatory environment in the wake of Worldcom, Enron, and homeland security mean compliance can eat up a lot of time and budget for suppliers whose core competency is production. So what can the small to midsized supplier do about it? Plenty, according to suppliers and supply chain advisors.



Can't We All Just Get Along?

Complaining is one option. That's just what happened at the first meeting of the Vendor Compliance Federation (VCF), a trade group, five years ago, when founder Kim Zablocky invited some suppliers and retailers into a room to discuss what he saw as overly aggressive behavior by retailers in taking deductions and chargebacks on orders.

"It was not a productive session," says S. Mark Jones, co-managing director of the VCF. "The vendors focused on the abusive side versus what retailers were trying to achieve. The retailers did not come back for several years."

On their own, however, most small and midsize suppliers are reluctant to jeopardize future orders by making too much noise about mandates and chargebacks. Audience members at a supplier seminar scoffed when the representative of a multibillion dollar apparel supplier advised them to simply negotiate with retailers on chargeback issues, says Norman Katz, president of Katzscan and an advisor to small and medium-sized businesses (SMBs) on vendor compliance. Some people believe retailers are intentionally vague in compliance manuals and use chargebacks as a profit center. "No one will say that publicly, but there is a lot of credence and evidence to support that," Katz said. Others vehemently contest that claim, viewing most chargebacks as justifiable.

Some suppliers only stand up to customers when they have nothing left to lose.

Attorney Rod Harmon sued The May Department Stores Company on behalf of SDG LLC, an apparel wholesaler that was going out of business, for $440,000 in damages for chargebacks which they contended were unauthorized and unjustifiable. Harmon claimed May Co. breached its contracts for the sale of goods by failing to pay the entire purchase price, while May contended the chargebacks were either agreed to by SDG or were justifiable as damages or nonconformity according to the terms and conditions of the purchase contracts. The two parties settled for an undisclosed amount, but Harmon feels he made some headway on behalf of the little guy by taking some of the incentive out of beating up suppliers. He wants faster feedback on chargebacks, fines that equal true retailer costs, and more fairness in the way suppliers are treated.

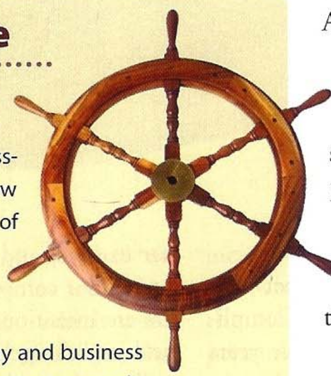
"If it's costing them a lot of money and they're getting sued over it, there's an incentive," says Harmon. He currently has two more class action suits underway, representing Adamson Apparel against Saks and CLC/CFI and Royal Apparel against Federated Department Stores.

Late last year The Home Depot received an "informal request for information" from the Securities and Exchange Commission, sparked by a whistleblower who was fired for what he alleges was his refusal to continue to follow orders to falsify documents padding the fees charged back to vendors for defective, damaged, or returned merchandise. The company was reaping as much as $40,000 to $50,000 a week at a store through the inflated claims, the worker charges. Home Depot has denied the allegations.

These developments have caught retailers' attention. "Retailers are now waiting to see what's going to happen," says Jessica Butler, principal of Attain Consulting Group, which offers guidance on solving chargeback issues. "Regulatory agencies are doing a lot of due diligence now and talking to vendors to get the dirt on retailers."

Of course, the flip side of non-compliance can be just as costly. In late 2001, Sony suffered a loss of $110 million when the Netherlands halted the sale of its Playstation game system because some cables contained too much cadmium. The cables were provided by a supplier who went against a Sony specification, according to an AMR Research study, *Environmental Compliance: Assessing Product Exposure and Executing a Strategy for Readiness*, August 2005.

Sailing Ahead of Compliance



At least one vertical market is getting out ahead of the supply chain inefficiencies caused by conflicting standards. The domestic marine industry bears the blessing and curse of employing little automation. While a few dominant players have some level of technology, much of the industry transacts business via phone, fax, and paper, using purchase orders that can list as many as 500 to 1000 line items.

"They recognize they're 25 years behind in technology and business operations," says Norman Katz, president of Katzscan, who is consulting with the National Marine Manufacturers Association to improve the industry's supply chain. They also saw the threat of manufacturing in China and wanted to improve domestic efficiency, he says.

So the NMMA's 1500 members, which are split between boat builders and accessories manufacturers, began collaborating together on industry standards—most recently, carton labels—and created the Marine Data Exchange (MDE), a Web-based EDI network with standard data file formats. Members communicate to the exchange through FTP files, in order to accommodate older legacy platforms. "It's competitors working together for the good of the industry," Katz says. While adoption has been slow, users get fast return on investment, he adds.

Sierra International, which is taking orders from two customers via MDX and is offering a price incentive for others to join, praises the NMMA's efforts to get out ahead on standards. The company also sells into another highly structured industry, automotive. "The Marine industry is doing the right thing by trying to get in front of it," says Joe Holtschulte, general manager of Sierra International.

A Spec Spectacle

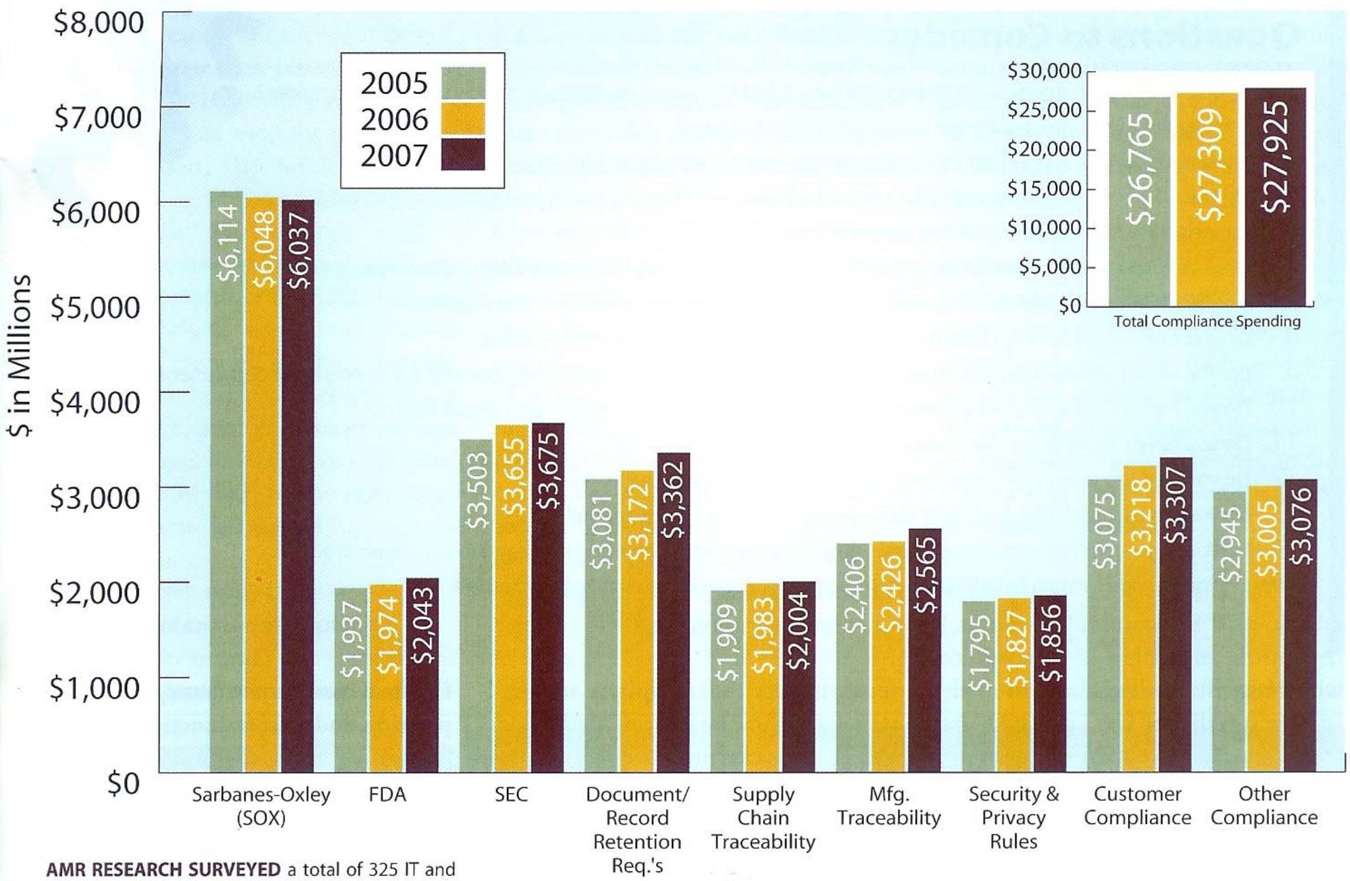
Specifications on how to pack boxes are just the tip of the iceberg for suppliers; vendor requirements are racking up and change is constant. Ford suppliers, for example, need to migrate EDI transactions with that company from its previous system, SOLMIS, to the Global Supplier Electronic Communications hub. Suppliers to the Army & Air Force Exchange Service are requested to accommodate the agency's move from intelligent to random purchase order numbers. Safeway suppliers are being asked to forecast projected weekly unit movement number by division for every new product and take the product back for list price if it doesn't sell 80 percent of that forecast.

None of these on their own are particularly difficult. But for a supplier with say, eight major customers, each making a few changes a month impacting several different departments in the company, there's real potential for changes to fall through the cracks and costs to mount.

On its own, "it can take a small to mid-sized business six months to a year to get a midrange mandate done, let alone a very difficult one," says Gary Keyes, vice president and partner at Liquio Corp., which offers Web-based supply chain compliance solutions. "It's a lot of time, development, and IT cost."

Retailer Gottschalks' fiscal 2006 vendor manual reflects its focus on keeping

Compliance Spending in 2005, 2006, 2007 – (Dollars in Millions)



AMR RESEARCH SURVEYED a total of 325 IT and line-of-business executives from a group of North American companies split evenly between manufacturing and services to determine in what areas of compliance companies will spend the most.

its supply chain moving and issuing penalties for vendors whose noncompliance slows that process. Violation of rule #1700, "Quality Removal From Cross-Dock to 100% Manual Processing," for example, incurs a $10 per carton fee, with a minimum charge of $250. For lower margin items, such moves can easily consume a supplier's profit.

In an annual survey on compliance by AMR Research, *Spending in an Age of Compliance, 2005–2007*, conducted in December 2005, the 325 respondents said their spending on customer compliance will grow the most (4.7 percent) from 2005 to 2006, though they'll spend more on Sarbanes-Oxley (SOX) and SEC compliance. Supply chain traceability spending will be 3.9 percent higher in 2006 than 2005. Document retention requirements will see the highest growth from 2006 to 2007.

Large customers do tend to get more stringent with their partners in times of crisis, says VCF's Jones. JCPenney, for example, drew grumbling from its supply base when it imposed strict requirements.

"JCPenney was going through a major transition several years ago and had to do things in its supply chain," he explains. "When you have to make major changes, you can't be soft and cuddly. You have to take a disciplinary approach, and they were tough. But they reached out to make sure vendors understood what was expected and what they were trying to achieve." The retailer has since made a lot of progress in its vendor programs, Jones says, and the VCF named JCPenney its Retail Industry Innovator of the Year for 2005.

In verticals such as retail, things may get worse before they get better. Over the next two to three years, many retailers are planning to implement vendor scorecarding, says VCF's Jones. The problem is, "scorecards and deduction policies are not fully aligned." He's concerned retailers might weight their myriad deduction types improperly, affecting how the retailer evaluates performance overall.

But there are some hopeful signs. "We've been seeing baby steps and recognition from retailers that they want to [standardize]," says Kathryn Cullen, principal with management consultancy Kurt Salmon Associates. Retailers' efforts to approach RFID

How Effective Is Your Compliance Approach? Questions to Consider

1. Is someone in your organization responsible for staying current on compliance manuals and routing guides?
2. Do they get the information to the people who need to know?
3. Is there a plan/process in place if you can't comply with a particular retailer requirement?
4. Do you effectively negotiate with your trading partners to get modifications, exemptions, and waivers?
5. Are people held accountable for this aspect of their job?
6. Does your sales department consistently inform you of "deals" they have made with customers on a timely basis?
7. Do you have a standard process to deal with the compliance requirements of new customers?
8. Do you meet with your key customers at least annually to discuss compliance issues?
9. Do you have a standard process to research deductions that was developed together with other operating departments?
10. Do you have a formal process to elevate and resolve deduction issues within your organization?
11. Do you have regular cross-functional meetings to discuss deductions?
12. Do you perform root-cause analysis for recurring preventable deductions?
13. Do you have a good track record for implementing process improvements?
14. Do you have standard reporting and measures used to communicate and manage the deduction process?
15. Do you provide training to individuals responsible for negotiating with your customers?

Source: Attain Consulting Group

with broader standards, as well as the coming together of UPC and EAN bar codes, is evidence of that, she says.

Jack, Be Nimble

Look for negativity in the world of vendor compliance and you're sure to find it. But compliance doesn't have to be that way. Perhaps the best news for suppliers is that much can be done within their four walls to boost compliance and recoup the cost of chargebacks—and maybe even profit from them.

"Improving compliance is within your own control, so focus there," advises Attain's Butler. In less than one year, one Attain client has reduced chargebacks to retailers by 77 percent by applying some basic reporting structure and discipline to compliance efforts, she says. Other suppliers have even exploited mandates to their advantage.

Suppliers are using multiple strategies to address their compliance issues:

Scrutinize your chargebacks.
The first step in improving compliance is addressing its causes. Attain's Butler recommends that suppliers to retail start by separating existing deductions and chargebacks into three types: *intentional*, such as sales related allowances, co-op advertising, and markdowns; *preventable*, which can be addressed by complying with customer standards; and *unauthorized*, which consists of a mix of compliance violations and retailer gamesmanship, requiring sound business practices and aggressive collection to recover. The same breakdowns can be modified for other industries.

Suppliers can reduce a lot of the hours that their accounting people have to spend verifying the validity of agreed-upon discounts by setting up processes to document and share them among the appropriate staffers, she says. They also need to code and classify chargebacks and determine which types predominate, so efforts to resolve compliance issues can be directed to where they get the biggest benefit. This structure will help address the third type of chargeback. "As vendors start to document these, questionable deductions start to go away," she observes.

Create a compliance manager position and a cross-functional team.
According to a March 2003 multi-industry survey by the Credit Research Foundation, *Customer Deductions, Impact on Receivables*, the number one internal challenge to controlling deductions was cross-department cooperation.

But the number of companies with dedicated compliance officers is on the rise, says Colin Masson, research director, supply network operations, at AMR Research, reflecting the increase in regulation and mandates.

A compliance manager needs to have the skills and clout to stay on top of customer and regulatory changes, disseminate those changes throughout the organization, and work with a cross-functional team of key contacts in each area that are also charged with ensuring compliance. That team should meet monthly, says Attain's Butler, and suppliers should sit down with each customer at least once a year specifically to discuss compliance—less than half do so, she says.

That strategy has helped marine accessories manufacturer Sierra International stay on top of compliance in the multiple vertical industries it serves. "We make sure each function is represented when processing new vendor agreements" and monitor them on an ongoing basis, says Joe Holtschulte, general manager of Sierra International.

Look for commonalities.

"A lot of compliance initiatives fall into common buckets," says Masson of AMR Research. "Everyone is asking basically for the same business processes. If you analyze them, a lot of requirements can be isolated into formatting or rules issues that can be handled by the right selection of software technology."

Maintain one technology platform to manage compliance.

One supplier to retail who worked with Norman Katz was operating 25 different applications to accommodate purchase order data from 20 customers. That's untenable, of course. Instead, suppliers should select one flexible platform, such as an ERP, and define a single input and output file format for each transaction and map each unique trading partner's requirements to and from those files. Tables should be created outside the system to store retailers' unique, extraneous data and processing requirements. "Drive everything to tables that users can manage with on and off logic."

For example, he says, if an accounting system doesn't handle invoice consolidation across multiple purchase orders, use a table to break them out and to consolidate data for the retailer before an EDI transaction. Similarly, mapping can help accommodate differences among trading partners' EDI formats.

Other tools can be layered on to extract the data needed to manage compliance. In retail, for example, chargeback management applications such as 9ci Inc.'s Web-based Deduction Control Module, or business intelligence tools such as Cognos, can help suppliers track and analyze deductions to look for patterns and errors. Compliance management tools and services such as Liquio's or Lanham Associates' Retail Supplier Link are available to help suppliers manage compliance without a lot of internal technology investment and integration, and EDI services are available to those without this capability in house. Similar tools are available in other industries, such as QAD's tool for FDA compliance for life sciences companies.

Act fast.

Uncover and address the issues behind chargebacks as quickly as possible, to head off the snowball effect that one error can cause. Monitoring chargebacks can detect early trends, such as an increase in incidence of a compliance violation.

View a mandate as an opportunity—look for the benefits.
"If you see competitors struggling, turn it into a competitive advantage by going over and above," says AMR Research's Masson. "Change the rules for your competitors. It becomes a differentiator. Sometimes going beyond the initial request can cost less money."

Look for the business benefit in fully embracing the recommended solution—an obvious example is internal use of RFID, rather than just slap and ship. Jack Link's Beef Jerky, for example, a midsize U.S. snack manufacturer, got out ahead of Wal-Mart's RFID mandate and turned it into an opportunity to leapfrog from manual internal operational controls to highly automated ones through its manufacturing process. The project, underway with the help of Microsoft and ABC Computers, will also help the company comply with USDA tracking requirements.

Collaborate with customers.
"Deductions are put in place as a way of encouraging behavior," insists VCF's Jones. "I don't want to come off as apologetic, but if people look back at the scale of what a retailer is trying to achieve," they'll understand the reasoning behind the rules. "Many retailers really don't want to be issuing deductions—it's administrative overhead."

In customer-supplier relationships, it's rare for the customer to spell out expectations so clearly, he observes—capitalize on that opportunity for improved customer satisfaction. Suppliers need to make an effort to understand where the customer is coming from.

The 80/20 rule likely applies to most suppliers, says KSA's Cullen—focus on your largest customers' needs and you'll likely address the lion's share of your issues and costs. Working together provides clarification for both sides.

Another step is to analyze how to best accommodate the requested change, even though that might mean using a different approach or application than the one a partner recommends. "You're saying, 'Yes, we can do this, but here is the technology we're going to use. We'll meet you in spirit,'" says Jones of VCF. Take a continuous process improvement approach to compliance.

Train staff on how to negotiate with trading partners. A collaborative approach can result in extensions, waivers, or other considerations, says Attain's Butler.

A typical response when first encountering a new mandate is to resist and do the bare minimum to comply. Sierra International, a marine accessories manufacturer, though, took the opposite tack—and it paid off:


Joe Holtschulte, general manager Sierra International

"We had one customer that was early to embrace standards, EDI, and had high expectations of suppliers," says Joe Holtschulte, general manager of Sierra International. "Early on we treated the customer as an exception, and we went on treating everyone else as we always had." Then the company shifted that tack and embraced that customer as the standard, developing processes to carry out that way of operating. "We recognized that what the customer was asking for was logical. Now the balance of the industry is moving to that standard," and Sierra has an early adopter advantage.

Look upstream.
Some compliance will require the cooperation of upstream suppliers and service providers. Suppliers need to take the same structured but fair approach with their own suppliers that they wish for from their own customers.

Analyze the Long-term Value.
There may be some requirements that it doesn't pay to meet. "Sometimes you can say no and they back off," says AMR Research's Masson. Sometimes it might not be worthwhile doing business with that customer.

Acting Together

In addition to getting their own houses in order, suppliers need to reach outside their organizations to foster a cooperative approach to compliance. At VCF, for example, "The vendors finally realized most problems they were experiencing were self-inflicted wounds," and decided to do something about it, says VCF's Jones.

So three years ago, the 360-member group took a new tack, taking a positive approach and corroborating together on best practices in compliance to mandates. Then retailers came back, now numbering about 40, and sister group Retail Compliance Council was formed. VCF started a database of issues and members' techniques to address them, say, how to implement Sak's new color coding on tickets and hangars. Last May VCF launched a clearing house that tracks changes to the compliance guidelines of more than 100 retailers—which amounted to about 1900 from May to December 2005—and alerts pertinent personnel within a member company about those changes. Two years ago the Retail Compliance Council announced a guideline for structuring vendor compliance manuals in a consistent way.

Another program is joint seminars with retailers such as JCPenney and Mervyns on how to implement their

programs, and VCF teaches compliance basics at every conference. "Vendors who attend conferences tend to perform better than those who don't," claims Jones.

Another avenue is vertical industry associations. The standards set by some of these groups offer the promise of reducing, if not eliminating, conflict among dominant supply chain players. Nearly every vertical market has some central group profligating standards for just these reasons. The chemical, high tech industries, and automotive industries are among those most evolved in standards-setting, and grocery has made good progress on data synchronization and trade promotion management, a cousin in structure to chargebacks.

"If you support that industry, you should support these like crazy," says AMR Research's Masson of industry standards efforts. "They solve problems for you," or at least mitigate them.

Industries already challenged by a variety of processes, formats, or even too-loose standards can still make improvements, Katz says. For example, in the retail industry, chargeback report formats could be standardized and use the same industry-accepted codes. "It doesn't have to be 100 percent," to offer significant benefit.

Regulatory Vs. Supply Chain Compliance

SOX has made compliance a top-of-mind issue for many CEOs, and there are some lessons to be learned from SOX and other regulatory compliance methodologies that can be applied to supply chain compliance—in fact, some supply chain issues have SOX implications.

Compliance with government regulations, such as those imposed on chemical, food, or drug manufacturing, importing/exporting, and so on, often involve documenting processes to prove a supplier is meeting requirements. Documentation is also needed to generate reports, keep licenses or permits up to date, and so on. The marketplace has produced myriad tools and methodologies to address compliance with SOX and other regulatory mandates, such as AMR Research's active compliance

Additional Compliance Info on Our Website:

Available only at www.chiefsupplychainofficer.com

➤ Hampton Products Locks Down Competitive Advantage

Hampton Products, a manufacturer of residential hardware, lighting, and travel security products, has to deal with a variety of practices and data but is using a combination of IT and strategy to compete. One of the company's goals was to provide better customer service by increasing already high fill rates and further reducing turnaround time. The company's on-demand supply chain management software, from Mitrix, can handle the wide variety of data formats and also provides role-based interfaces for Hampton managers and executives, as well as a portal for suppliers and customers. But the company is looking at additional ways to improve performance.

➤ How Two Suppliers Gained Scorecard As

Suppliers to retail—such as Revman and Ellery Homestyles, LLC, in New York City—have reduced their chargebacks and enhanced relations with retailers at the same time by taking a structured, collaborative approach to complying with their customers' mandates. Both companies follow Attain Consulting Group's guidelines for compliance.

architecture (*Planning for a Sustainable Active Compliance Architecture*, February 26, 2004).

Those same business processes and documentation infrastructure can be useful in supply chain compliance, to record events and tease out trends in data that show where supply chain processes need to be improved. They can also help uncover supply chain events with SOX implications. For example, a company's noncompliance with a major customer's mandate that endangers a major contract, or a raw material supply that is at risk, become SOX-reportable events.

"If you're not paying suppliers what you owe them, that is a liability that ought to show on the books," says Rod Harmon. "You're not showing shareholders a potential problem, and that's an SEC problem." In responding to its SEC inquiry, Home Depot made a point of telling the press its internal controls related to vendor policies preclude any potential for material adverse impact.

Failure to comply with government supply chain requirements, such as import and export controls, can have similar consequences. According to Larry Christensen, vice president of export compliance controls for JPMorgan Chase Vastera, the U.S. government is holding C-level executives and board directors responsible for ensuring an effective global trade compliance/security program and has spelled out the need for well documented, repeatable, auditable processes to ensure compliance. These steps are very similar to what's required to meet suppliers' mandates.

The term compliance has come to have punitive implications, and many small to midsize suppliers still tend to view compliance mandates that way—occasionally with good reason. But those who turn that concept on its ear and take a more strategic view of the reasons behind the rules have found a way to turn requirements into opportunities, making compliance a competitive advantage. ■

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