GOODS NOT FOR RESALE

HOW MUCH VALUE ARE YOU LEAVING ON THE TABLE?

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In tough times, retailers are always looking to increase operational efficiency and reduce costs. But there's one place they seldom look hard enough: goods not for resale (GNFR). GNFR typically represents around 25% of a retailer's total operating cost, meaning that it accounts for 6–8% of revenues. Despite its importance, GNFR is rarely scrutinised in the same way as other costs such as in-store labour – making it a major source of untapped savings, even for retailers who have already tried clamping down on spend.

The simplest way to deal with GNFR is through temporary cost cuts or simplistic budget adjustments: "no travel and entertainment for the time being", "take 10% out of the marketing budget", or "no new computers this year". These approaches are often perceived by employees as arbitrary, and they don't generate sustainable savings. Because ways of working and patterns of spending remain unchanged, costs creep back and, in some cases, even increase.

Even for retailers that have run significant GNFR programmes or built dedicated groups to address GNFR, the untapped potential often remains considerable. How can this be? In simple terms, this is because many purchasing categories are not covered or only the basic performance levers are pulled.

Only a small number of retailers have successfully set up a holistic GNFR operating system, adopting best practices from leading manufacturing companies. This capability gives these retailers a real competitive edge, generating substantial and sustainable savings, while at the same time leveraging supplier innovations to improve commercial effectiveness and the customer experience.

WHAT ARE GOODS NOT FOR RESALE?

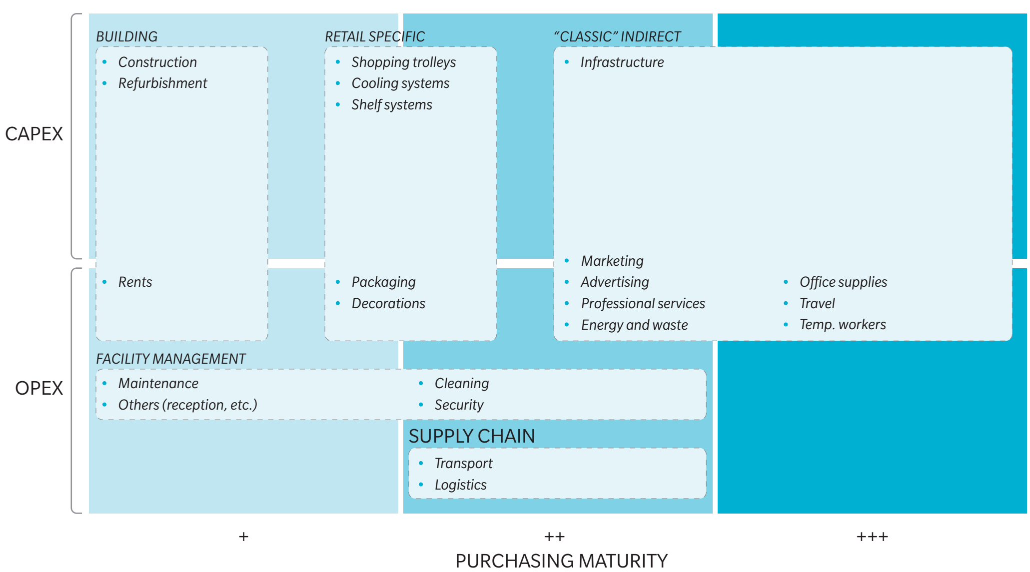
A common belief is that GNFR consists only of simple products and services, such as bags and cleaning, and that it's simple to manage. This is wrong in a number of respects.

Firstly, GNFR has various segments that require different approaches, and where retailers' cost management capabilities tend to be at very different levels of maturity, as shown in Exhibit 1:

- **Consumables** (for example, checkout bags, packaging for fresh products, anti-theft devices) characterised by low unit prices, high purchasing volumes, a fragmented supplier base, and high volume purchase orders. In some ways these can be similar to goods for resale (GFR) when it comes to procurement
- **Equipment** (for example, store shelves, cooling systems, power equipment) requiring a comprehensive and often complex total cost of ownership (TCO) view, detailing several cost dimensions such as installation, maintenance, spare parts, and energy consumption
- **Services** (for example, IT services, cleaning, security, temporary labour) requiring complex standardisation and volume pooling arrangements across stores

Secondly, GNFR covers both operating expenses and capital expenditures, both of which require specific budgeting constraints and dedicated decision processes. This complexity makes it difficult to see the integrated financial picture: if real estate purchases elevators but operations pays for their maintenance and repair, it can be hard to know what they really cost.

EXHIBIT 1: GNFR MACRO SPEND CATEGORIES AND TYPICAL MATURITY LEVELS



Thirdly, some GNFR categories can be considered as highly sensitive, making them "exceptions to the rule" when it comes to managing costs. This can be because of:

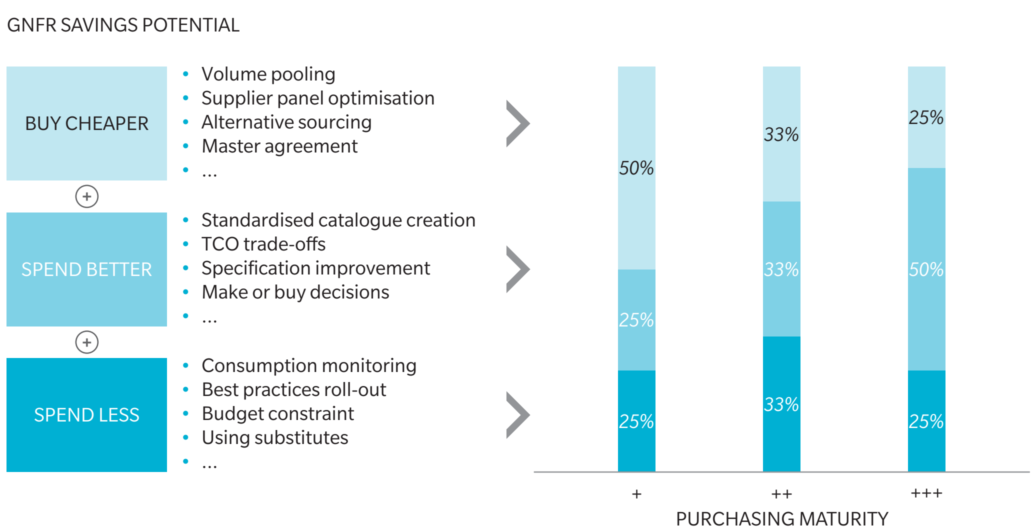
- Internal organisational prerogatives: IT, marketing, and logistics, for example, are often "protected areas" outside the scope of procurement
- HR considerations: some policies may impact on employee morale (for example, travel and entertainment, company vehicles)
- Visibility to customers: cutting spend in customer-facing areas (such as store cleaning, checkout bags, cooling equipment reliability, or checkout systems) can translate into lost revenue

And finally, GNFR is characterised by large numbers of prescribers and users scattered throughout the organisation, meaning that decision-making processes are highly decentralised. This in itself gives rise to some major challenges. What this means is that retailers' scope is usually too narrow when it comes to managing GNFR expenditure. In general, the spending being considered accounts for less than half of the total cost base, and the ways retailers think about reducing it are too limited. As a result, most of the available value remains untapped.

WHAT'S AT STAKE?

GNFR is a significant cost item, typically representing 6–8% of a retailer's total revenue. In our experience, there is scope to reduce GNFR spend by between 10% and 15% of savings over three years: a total cost reduction of 50–100+ basis points. In any retail sector, the value at stake is enormous. But achieving these results takes much more than simply optimising procurement transactions through renegotiation or volume pooling. Fundamentally, there are three ways to manage GNFR costs: buy cheaper, spend better

EXHIBIT 2: THREE PERFORMANCE MACRO LEVER TYPES TO BE LEVERAGED



and spend less – Exhibit 2 shows the savings potential of each. To get the most from GNFR optimisation, all three must be applied in a coordinated way.

BUY CHEAPER

Most retailers focus their GNFR cost reduction efforts on a subset of the things they buy, and on buying cheaper: in other words, purchasing essentially the same products or services for a lower price through enhanced competition, pooled volumes, or renegotiation with suppliers. Of course, this is often where quick wins are found and where there will be the least friction between procurement and the rest of the business. But innovative or alternative levers can offer additional savings: for instance, some retailers have set up disruptive anti-theft devices or more creative sourcing schemes, leveraging low-cost countries sourcing price opportunities combined with their GFR import structure to optimise total costs.

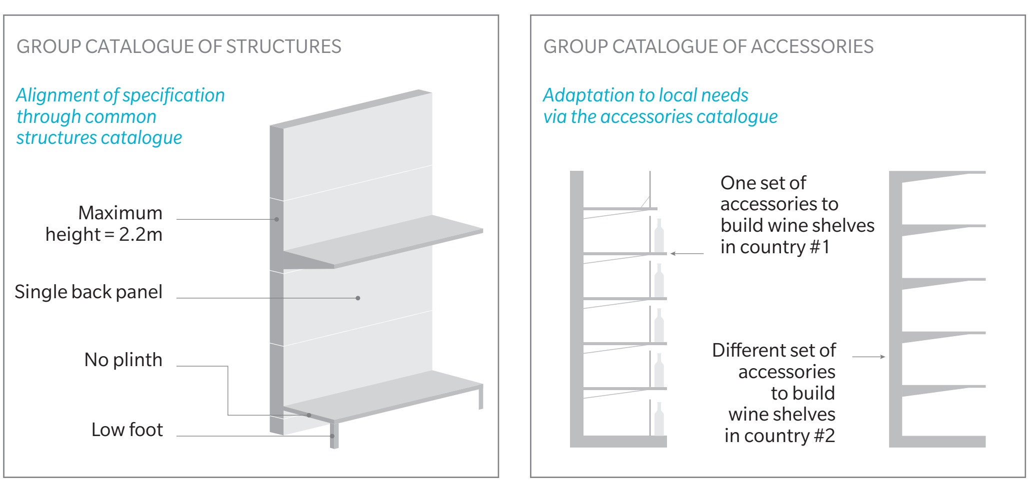
SPEND BETTER

Spending better is about shifting the focus from the product being bought to the business need it satisfies. This might mean challenging specifications or ensuring the actual "need" conforms to catalogue standards; in all cases, the aim is to have an impact on the procurement activities downstream.

For instance, when specifications for store shelves are managed locally in different countries and for different formats, the final number of SKUs purchased can easily total several thousand, and this naturally constrains the buyers during negotiations. To reduce this complexity, some retailers have set up a common standard for shelf structures based on corporate rules combined with a catalogue of accessories, as shown in Exhibit 3. This enables them to take into account all local variations: each country can "rebuild" its own store shelves by using different accessories, and buyers can pool volumes based on simplified and common standard catalogues.

EXHIBIT 3: STORE SHELVES SPEND OPTIMISATION EXAMPLE

HOW TO LIMIT SKU PROLIFERATION WHILE KEEPING LOCAL MARKET SPECIFICITIES



SPEND LESS

Spending less – in essence, reducing volume – is conceptually simple but tricky to implement. In many cases it isn't worth optimising costs by buying cheaper and/or spending better unless consumption volumes are also tightly monitored. Spending less requires that consumption monitoring metrics are developed, shared objectives are defined, consumption rules and policies are set, and a culture of cost control is established – for every procurement category across the entire organisation.

Take in-store energy use, for example. Here there are several tactics a retailer might employ to reduce consumption. Energy consumption labels can encourage more efficient behaviour by store employees. Sub-area energy meters can monitor energy consumption profiles (areas, hours, seasonality) and be used to create action plans for optimisation. New, lower energy consumption target levels can be set. And communication programmes can be set up to enable sharing of best practices across stores and to create awareness among employees.

Moreover, optimising GNFR in these ways typically has positive side effects:

- Performance initiatives can reinforce the eco-friendly image of a retailer, such as energy consumption optimisation, biodegradable checkout bags, waste management optimisation
- Performance initiatives can also encourage more innovative solutions from suppliers, support the development of sales, or improve in-store productivity
- Finally, a GNFR costs initiative also has a positive "social" perception as it targets cost reductions without impacting on the labour force

UNLOCKING THE POTENTIAL OF GNFR

In our experience, there are five different things a retailer needs to do to unlock the untapped value of GNFR cost optimisation:

1. SUPPORT THE PROGRAMME STARTING FROM THE TOP – AND GO ALL THE WAY TO THE BOTTOM

CEO and CFO involvement is essential not only to create momentum and buy-in throughout the organisation, but also when objectives are being defined and cascaded down to the operational management layers of the company (for example, when setting store budgets). If the objectives are not aligned across the company as a whole, GNFR optimisation goals are never likely to be achieved. Making sure targets are cascaded down to the different business owners is therefore essential.

2. INVEST 5% IN STRATEGY AND 95% IN EXECUTION

The fragmented nature of GNFR spend means that optimising entails managing a programme that covers several thousand individual performance actions – by country and region, by store, and by category. Getting the details right is essential, because savings don't come from a handful of key initiatives that deliver 80% of the benefit but from a very large number of small initiatives, some global, some local. Delivering a programme of this size, scope, and complexity requires strong project management capabilities, and the establishment of tools and methods to prioritise appropriately, allocate resources, and monitor progress.

3. DRIVE CHANGE THROUGH WORDS AND DEEDS

Change management is essential for such initiatives. To convince sceptics, recommendations need to be supported by fact-based business cases and tangible analysis. And when it comes to changes in usage or specifications, management need to be exemplars, championing the shift in culture required. A coordinated communication plan will be needed to support the change process, and this is a major commitment in itself. It might require a "roadshow" to visit every store, highlighting how proposed changes affect the bottom line and explaining how they have been arrived at – with particular attention paid to any changes that will be visible to customers.

4. SET UP A NEW OPERATING MODEL FOR GNFR

Bringing GNFR costs down significantly – and keeping them down – always requires a new, holistic approach. This means hiring professional buyers for each category, paired with a lead prescriber to define shared technical and procurement strategies: these buyers need a career path that offers similar opportunities as for GFR buyers, and there should be opportunities to move between GFR and GNFR. It requires striking the right balance between the level at which a procurement category should be managed (worldwide, national, or regional) and the way internal clients (prescribers and users) are organised. And it means securing rigorous and systematic provisioning processes that extend right down to store level to track user satisfaction, monitor spend, and ensure compliance with master agreements.

5. SECURE BOTTOM-LINE IMPACT

Making sure that the impact of cost reduction really does make it to the bottom line is vital for demonstrating success and sustaining support for the programme. Savings targets must be embedded in the budgeting process to avoid them simply "evaporating", and there needs to be a detailed reconciliation between expected procurement savings and actual financial impact to ensure buy-in from all parties involved. Building an e-procurement tool is one way to ensure effective contract enforcement and track consumption evolution.

CONCLUDING REMARKS

To get the most from GNFR optimisation, it needs to be much more than just "another project from the procurement department" and to go far beyond "cost cutting" or "negotiations". If a leadership team really wants to maximise the value of such a project, and systematically explore and exploit all cost levers, this will mean mobilising and engaging with the entire organisation.

When GNFR optimisation projects are addressed in this way, they can generate enormous benefits, greatly improving a retailer's overall profitability and freeing up funds to invest in new growth opportunities. Capturing the savings available is a real challenge – but the value at stake makes it one worth meeting head on.

ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation.

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