



Logistics Association of Australia Ltd

LOGISTICS UNDERSTANDING THE “COST TO SERVE” AT SUPERVALU INC. (Part 1)

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Supervalu Inc., head-quartered in Eden Prairie, Minnesota, is the largest food distribution business in the United States with 15% of the market and is the nation's 13th largest food retailer. In 1998, 71% of the net revenue (US\$17.2 billion) was derived from wholesale distribution and 29% from corporate owned retail operations. Products supplied are classified into nine categories:

- Dry grocery
- Produce
- Meat
- Frozen Food
- Dairy
- Bakery
- Deli
- General Merchandise
- Health and Beauty Care

Supervalu in brief...

Net sales in 1998 – US \$17.2 billion

Net profit before tax in 1998 – US \$385 million

Employees – 48,000 full and part time

Supplies 4,800 stores in 48 states

36 Distribution centres

328 Corporate owned stores

Save-a-lot subsidiary services 701 limited assortment stores (142 corporate owned and 559 licensed) through 11 distribution centres

In the mid-nineties, Supervalu undertook an initiative it termed “Advantage”. This was in response to changes in manufacturer selling prices and other shifting industry dynamics and basically represented a complete reinvention of the company’s distribution business.

The primary goal of the Advantage project was to make its retailers even more competitive by creating a supply system that delivered goods at a lower cost to them. One component of the project is the multi-tier distribution strategy, a combination of new regional facilities for slow moving items to support the existing full-line distribution centres.

A new pricing system called Activity Based Sell (ABS) was introduced in 400 stores and shows signs of improvements in item promotion, streamlined delivery schedules and product ordering and reduced non-productive inventory. The retail businesses are aiming to improve operating efficiencies as part of the initiative by concentrating merchandising and operations efforts in the regions and adopting a more chain-like, standardised support organisation.

Going for growth... The Advantage initiative will continue to be consolidated in 1999, supported by three growth strategies:

- **Organic growth of independent retailers**

Supervalu offers them a full range of formats and support services, facilitating remodels and store upgrades and assisting in retailer financing. Services such as customer loyalty, cards are also seen as growing trends.

- **Actively pursue retailers served by other wholesalers**

In 1998, customers attracted by Supervalu's distribution expertise and efficiency added approximately US\$518m in sales.

- **Make inroads in attracting chain business**

Developing long-term supply relationships with larger chain outlets such as 183 Jewel stores in 1998. This also entails the provision of third party logistics provider services to other chain businesses.

Supervalu has budgeted for capital spending in 1999 of US\$370m

incorporating:

food distribution activities - facilities, IT and normal spending

- US\$133m - retail food projects - 39 new stores and 30 limited assortment stores

projects - IT and other spending

- US\$187m -

- US\$50m - general

The key initiatives for 1999 will include:

- Gain greater efficiencies in the logistics network

- Reduce inventory days supply by 2

- Continue to standardise systems

- Achieve greater private label penetration

- Pursue scale and scope opportunities across the entire business.

Minneapolis Distribution Centre...

In 1995, Supervalu aligned its 25 divisions into a regional structure, with Minneapolis chosen as the Headquarters for the Northern Region. I had the opportunity to make a brief visit to this facility and some of the key facts for the site follow:

- **Warehouse Building Sizes**

- Perishables - Includes 15 banana ripening rooms and an expanded meat storage area - 21,600 sq. metres
- Dry Grocery - Also includes offices for retail accounting, Northern Region Category Management, Corporate Market Analysis and Market Research and Risk Planners - 56,800 sq. metres
- Grocery - Also includes the Northern Region Administrative offices, dry grocery and general merchandise warehouses - 53,200 sq. metres
- Freezer Storage - 13,400 sq. metres
- Fleet Maintenance Facility - responsible for the maintenance repair and cleanliness of all transportation equipment - 7,700 sq. metres

The facility services more than 250 stores with approximately 835 employees on a seven day a week operation. More than 70,000 truck loads of product are received annually through 199 shipping and receiving doors with an average inventory on hand of approximately US\$90m. Approximately 27,000 items are carried with the bulk being in Grocery, General Merchandise and Frozen Goods.

Cost to Serve - A Starting Point...

As part of the Advantage initiative, a prototype for the cost to serve (CTS) model was developed in 1994 jointly by Supervalu people and outside consultants. It was of limited scope in terms of operations reviewed and time periods included. The concept, once proved, was handed to the Activity Costing group to find a way to systematise the prototype and balance the 'ultimate' with what was practically achievable. Benefits were to be realised as soon as possible.

The objectives were to provide a system that measured and reported cost to serve information using activity based costing principles. This supported Supervalu's activity based management approach. The project was targeted at consistent information and analyses regarding the cost to serve Supervalu's wholesale customers. It provides periodic reporting to regions and corporate management.

The system provides a quantitative view of revenues and costs attributable to a customer or group of customers. It provides valuable information (and is certainly in demand based on observations during my visit to the Minneapolis warehouse) in the management decision making process.



Cost to Serve - what it is and isn't...

One of the key points made about the system is that it is NOT an accounting system. It's an analytical tool used to organise costs around the key activities of the workflow. It's more a scorecard or an attention getting tool in the words of Mark Czerwonka, Manager of the Activity Costing Department.

It provides a level of consistent reporting from Division to Division and this allows management to ask the questions about why one location can service a group of customers but incur different levels of cost to one serving a similar group elsewhere. The prime users are the Director of Business Analysis and support staff who are responsible for supporting the CTS in the regions. Information is also shared with Retail Operations, Business Development and logistics.

The Cost to Serve system must tie back each month to the Divisional Profit and loss statement to ensure the integrity of the allocations is maintained and confidence in the system by the users remains intact. It hasn't been without its critics within Supervalu, however, the proven success of the system and constant attention has resulted in its acceptance. This is combined with the fact that senior management actively review the results (the old saying about what gets measured, gets managed certainly is evident here).

The system provides a "what-if" capability that has been of great value in evaluating potential structure or service changes.

Believe it or not!

A few interesting (or not) facts about the Minneapolis operations:

- The site utilises 112 fork lifts costing about US\$35,000 each
- There are 174 motorised pallet jacks costing about US\$1,500 each
- 74 Prime movers transport product over 5 millions miles annually.

How is CTS used at Supervalu...

CTS data is used to provide exception reporting. It also allows for the review of operational characteristics at product level by customer and can provide data to support corrective action. It also allows the comparison of results by retail group, format, etc.

There is a clear operational focus on minimising costs and providing the appropriate level of service for each store. The CTS system allows for the measuring of costs of servicing stores (both corporate and independents). Changes can then be made as needed to improve operational efficiency.

What does the CTS do and which costs are measured...



The CTS system captures all distribution centre operational costs. These costs are then assigned to each store served, based on key cost drivers. All retailer specific variable costs are captured. Fixed and non-specific costs are allocated to each store based on appropriate cost drivers.

Direct distribution costs including warehouse receiving, selection, loading and overhead as well as facility costs and trucking expenses form the basis for the CTS system. Administrative costs are also included and allocated and these tend to generate the most controversy when analysing results.

In the next issue...

Space in this month's issue of the newsletter unfortunately doesn't allow for the further detail on the allocation of costs, etc. I'll provide some of the background on these costs and the method of allocation in the next LAA issue. In the meantime, if anyone has questions or would like more information on the CTS system, please drop me a line.

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