CHAPTER I  

STATEMENT OF THE PROBLEM

1.0 Introduction

Indian economy is as turbulent as any other economies today world over. Consequently, every sector of business is facing severe competition in the market in both local and international markets. The traditional corporate organizational structure based on vertical integration, hierarchy, and functional management is not readily amenable for responding to the changes. Therefore, necessitating the need for drastic change in the traditional and modern business world, where in, when demand became unpredictable in both quality and quantity, when the domestic and international markets became too diversified and thereby difficult to forecast, and when there is a dynamic change in the technology which made single-purpose production equipments obsolete, the mass-production system became too costly and too rigid. Innovative technologies allow for the transformation of assembly main characteristic of the large corporation into easy-to-program production units with product flexibility sensitive to market variations, and process flexibility sensitive to changes in technology. All such changes have, by and large, stimulated for renewed supply chain management in
all sectors of business in general and retail sector in specific for its unique nature. To this effect, the present study is all about understanding the supply chain management practices across a wide range of retail outlets in the twin cities of Hyderabad and Secunderabad. Further, how effective are these systems across these outlets.

1.1 Background

Most of the modern organizations have adapted the new environment and the main shift is featured as the shift from the vertical bureaucracies to horizontal corporations. There are seven major modern trends which features such corporations and they are as organizing around process, not tasks; a flat hierarchy; team management; measuring performance by customer satisfaction, maximization of contacts with suppliers and customers; information, training and retraining of employees at all levels and rewards based on team performance. Contemporary business life cycle is process driven and chain oriented; hence integration has become a core-question for companies. The problems and challenges with the traditional vertical co-operation between organizations are costly and time consuming, instead of co-operating; there is also no scope of cost reductions or profit improvements at the expenses of someone else in the supply chain.
The supply chain is defined here as a part of a network that supplies a specific product from raw material to final customer – it is a whole commercial chain embedded in the network (Hertz 2001) with a common objective of efficiency and effectiveness. Efficiency is an internal standard of performance while effectiveness is an external standard of fit to various groups’ demands (Pfeffer and Salancik 1978). To that effect, this study intends to explore the effectiveness of roles performed by the Supply Chain functionaries in FMCG sector.

There are various ways to look at supply chain. One can say that it starts from the raw material vendor and ends with the customer; thus, it includes purchasing, marketing and even consumer buying the product. Therefore all the processes involved in the entire spectrum from demand generation to demand satisfaction can be called as supply chain management. Today, in some advanced companies supply chain extend right from the vendor procuring his raw material to the point of sale where the last sale of the product takes place. This implies that there is transparency and information flow in the entire chain resulting in appropriate action at each point. This action by each entity contributes to the smooth functioning of supply chain.
In some companies supply chain could only be internal that is across the manufacturing facilities to company owned depots. One can always choose a part of the supply chain that is most relevant and focus resources to achieve increased productivity.

The objective of every supply chain should be to maximize the overall value generated. The value a supply chain generates is the difference between what the final product is worth to the customer and the costs the supply chain incurs in filling the customer's request. For most commercial supply chains, value will be strongly correlated with supply chain profitability (also known as supply chain surplus), the difference between the revenue generated from the customer and the overall cost across the supply chain. For example, a customer purchasing a mobile Best Buy pays Rs.1800, which represents the revenue the supply chain receives. Best Buy and other stages of the supply chain incur costs to convey information, produce components, store them, transport them, transfer funds, and so on. The difference between the Rs.1800 that the customer paid and the sum of all costs incurred by the supply chain to produce and distribute the router represents the supply chain profitability or surplus. Supply chain profitability or surplus is the total profit to be shared across all supply chain stages and intermediaries.
The higher the supply chain profitability, the more successful is the supply chain. Supply chain success should be measured in terms of supply chain profitability and not in terms of the profits at an individual stage.

Having defined the success of a supply chain in terms of supply chain profitability, the next logical step is to look for sources of revenue and cost. For any supply chain, there is only one source of revenue: the customer. Thus, the appropriate management of these flows is a key to supply chain success. Effective supply chain management involves the management of supply chain assets and product, information, and fund flows to maximize total supply chain profitability.

Retailing is largely consolidated, with large chains buying consumer goods from most manufacturers. This consolidation gives retailers sufficient scale that the introduction of an intermediary such as a distributor does little to reduce costs and may actually increase costs because of an additional transaction. In contrast, India has millions of small retail outlets. The small size of Indian retail outlets limits the amount of inventory they can hold, thus requiring frequent replenishment—an order can be compared with the weekly grocery shopping for a family in Mumbai.
The only way for a manufacturer to keep transportation costs low is to bring full truckloads of product close to the market and then distribute locally using "milk runs" with smaller vehicles. The presence of an intermediary who can receive a full truckload shipment, break bulk, and then make smaller deliveries to the retailers is crucial if transportation costs are to be kept low. Most Indian distributors are one-stop shops, stocking everything from cooking oil to soaps and detergents made by a variety of manufacturers. Besides the convenience provided by one-stop shopping, distributors in India are also able to reduce transportation costs for outbound delivery to the retailer by aggregating products across multiple manufacturers during the delivery runs. Distributors in Mumbai also handle collections, because their cost of collection is significantly lower than each manufacturer collecting from retailers on its own. Thus, the important role of distributors in Mumbai can be explained by the growth in supply chain surplus that results from their presence.

1.2. Supply Chain Management

The phrase supply chain management (SCM) lacks a clear definition. A literature review reveals that it has become an expression in business literature used to incorporate almost anything within the field of marketing and logistics.
**Supply Chain**

"A supply chain is the set of entities that collectively manufactures a product and sells it to an endpoint." The ultimate beginning point is where raw materials are being extracted and the end point would be where goods and services are being consumed, or perhaps even recycled. However, this view is extremely comprehensive and obviously very difficult to put into a practical context. Therefore, the business view on supply chains is somewhat arbitrary, leaving managers to decide their own boundaries of the supply chain. The alignment of firms is in the literature alternating called a supply chain, a demand chain, a value chain, or a marketing channel.

**Supply chain Function**

The work in a supply chain includes the performance of label marketing flows. Nine generic flows between channel members are identified. Some of the flows move forward through the channel (physical, ownership, promotion), some move backwards (ordering and payment), whereas other flows move in both directions (negotiation, financing, risking, information).
This framework is almost 40 years old; I consider it to be highly relevant for my case studies, as it can be used to describe a retail-customer interface in a structured way.

1. Bulk-breaking refers to the opportunity for consumers to buy in small lot-sizes, allowing them to transform purchases easily into consumption, thus reducing the need for consumers to carry unnecessary inventory.

2. Spatial convenience denotes that products are being supplied close to the consumer, thereby reducing transportation and search costs. Examples of channel forms with spatial convenience are neighborhood supermarkets and vending machines.

3. The longer the waiting or delivery time, the more inconvenient it is for consumers, who are required to plan consumption in advance.

4. Finally, the greater the product variety available to the consumer, the higher is the service output. Greater assortment usually entails
carrying more inventories, which is reflected in higher distribution costs.

All things being equal, consumers will choose products with higher service level. But all things are normally not equal, instead it is a matter of making a tradeoff between price and service level. The higher the service output, the higher is the value for consumers, but the higher are the costs for channel members and, consequently, the higher is the price for consumers.

1.2.1. Putting It Together: What Is Supply Chain Management?

The actual term SCM was introduced by consultants in the early 1980s, and picked up by academics at the end of that decade. Since then, the confusion around the two terms SCM and logistics has been immense; some even seem to use the terms as synonyms, and one can wonder what the differences really are. Consider logistics, which they define as "the management of the flow of physical material", to have metamorphosed into the concept of SCM which, in turn, has come to include every element of the supply chain. Christopher has a similar understanding, also explaining the concept of SCM to be an extension of the logic of logistics. Logistics Management defines logistics management as:
"That part of the supply chain process that plans, implements, and controls the efficient, effective forward and reverse flow and storage of goods, services, and related information from the point-of-origin to the point of consumption in order to meet customers' requirements"

The roots from logistics are obvious. Still, SCM can be considered more extensive than logistics management as it attempts to integrate not only logistical activities, such as material, value, and information flows, but all key business processes that companies perform across the supply chain. SCM integrates supply and demand management within and across companies and coordinate processes and activities across functions such as product design, manufacturing, marketing, and sales. Advocates definitely regard SCM to be more than a new name for logistics. Implementation of SCM involves identifying important supply chain members with whom it is critical to link, what processes need to be linked to each of these members, and what type or level of integration to apply for each process link. Process integration should aim at increasing total process efficiency and effectiveness across all members of the supply chain, not only across functions within single companies.
1.2.2. Different Supply Chains For Different Products Aspects Of Demand

Organization or organization managers lacking a clear understanding for which SCM ideas and technologies are best suited for their company, risk end up in a mismatch between their type of product and their supply chain. It also suggests that the first step to be considered is to examine the nature of the demand for products. According to my finding, products fall into two categories when based upon their demand patterns:

1. Primarily functional products having stable and predictable demand as well as long life cycles (e.g. groceries)
2. Primarily innovative products supposed to satisfy additional needs, thus demand and life cycles becomes unpredictable. (e.g. fashion apparel, computers)

**TABLE 1.1: FUNCTIONAL VERSUS INNOVATIVE PRODUCTS: DIFFERENCES IN DEMAND**

<table>
<thead>
<tr>
<th>Aspects of Demand</th>
<th>Functional</th>
<th>Innovative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product life cycle</td>
<td>More than 2 years</td>
<td>3 months to 1 year</td>
</tr>
<tr>
<td>Contribution margin (price minus variable cost divided by price)</td>
<td>5% to 20%</td>
<td>20% to 60%</td>
</tr>
<tr>
<td>Product variety</td>
<td>Low (10-20 variants per category)</td>
<td>High (often millions of variants per category)</td>
</tr>
<tr>
<td>Average margin of error in the forecast at the time production is committed</td>
<td>10%</td>
<td>40% to 100%</td>
</tr>
<tr>
<td>Average stock out rate</td>
<td>1% to 2%</td>
<td>10% to 40%</td>
</tr>
<tr>
<td>Average forced end-of-season markdown as percentage of full price</td>
<td>0%</td>
<td>10% to 25%</td>
</tr>
<tr>
<td>Lead time required for made-to order products</td>
<td>6 months to 1 year</td>
<td>1 day to 2 weeks</td>
</tr>
</tbody>
</table>
Innovative products are synonymous with high contribution margins and inconsistent demand in comparison with functional products, which are stable and have low margins. Therefore, these two categories are said to require fundamentally different supply chains.

1.2.3. Physical vs. market mediation costs

It proposes that a supply chain accomplishes two distinct types of functions: a physical function and a market mediation function. The physical function includes converting raw materials into products and transportation from one point in the supply chain to the next; the costs lie within production, transportation and inventory storage. The market mediation function is less visible since its purpose is to make sure that the products reaching the market Place matches consumer demand; cost will appear when supply exceeds demand and the price has to be marked down, or the opposite, when demand is greater than supply, resulting in lost sales opportunities and dissatisfied customers.
Since the demand of functional products is assumed to be predictable, market mediation is relatively easy and a good match should be achieved. Companies producing such products are therefore able to mainly focus on minimizing physical costs within the supply chain in order to meet demand at the lowest cost, creating a physically efficient process. That approach is not suitable for innovative products since the uncertain market reaction to innovation multiplies the risk and possible costs of shortages or
excess supplies. As market mediation dominates costs for innovative products, they should be given priority. Important in such supply chains is information about the marketplace to become as responsive as possible.

As functional products require an efficient process and innovative products require a responsive process, companies positioning themselves. When put this way, it appears as if there only exists these extremes with functional supply chains on the one hand, and responsive supply chains on the other. The divisions are probably not that obvious and the boarders not that clear. We think that the main point to be made is that supply chains need to be thoroughly designed and adjusted to a company's specific value proposition. If the value proposition is based on high fashion content, speed is important (responsiveness) and if it is based on low prices, low distribution costs (efficiency) are important. Even though the above presented uncertainty framework deals more with how supply chains should be devised than how they actually are devised, rather normative writings do seem sound. It would be interesting to see how well this theory is rooted in reality.

1.2.4. Demand Uncertainties

A slightly broader angle is put forward framework is widened to include also supply uncertainties. In a "stable" supply process, the underlying technology and the manufacturing process are mature,
and the supply base relatively well established. The opposite of a stable supply process is an "evolving" process where the technology is still under intense development; the supply base may therefore be limited both in size and experience. Examples of products with stable supply sources are groceries and apparel, while hydroelectric power and telecom products are examples of evolving supply sources. This widened framework is not really suitable here, as our case companies fall into the category having stable supply sources.

1.2.5. Strategy: delivering the value proposition

The literature in business strategy is extensive and a review of the different schools of thought in this field is not necessary for the purpose of this paper. Here we will only briefly justify our choice of strategy literature. One distinction can be made between those schools that focus on the strategy process, i.e. the manner in which strategies come about, and on those schools that focus on the strategy content, i.e. the product of the strategy process. As the purpose of this thesis is to describe and analyze connections between retail value propositions and supply chains, it becomes natural that literature on strategy content is most relevant here. One of the most influential writers in this field is Michael Porter, and as we find his framework sound and credible, we chose that for our study. Still, we are aware of some of the critics that has been put forward against Porter, arguing that his writings are too top-down
focused and prescriptive in nature, focusing more on the content and how strategies should be formulated than on how they actually emerge.

"What is strategy?" actually starts with what strategy is not, as he argues that operational effectiveness is too often mistaken for strategy. Operational effectiveness is about achieving excellence in individual activities thus moving closer to the productivity frontier, i.e. the state of best practice. Focusing too much on this is what Porter calls the exercise of mutually destructive competition, as the homogeneity leads to decreasing margins for all companies.

There are two main types of competition: optimizing and strategic. Accordingly, companies can reach competitive advantage either through lowest costs or through differentiation; "companies can run the same race faster" or "choose to run a different race". The essence of thinking about strategy is that strategy rests on uniqueness, i.e. delivering a unique value proposition versus competitors. This is achieved either by choosing to perform activities differently than competitors, or by performing different activities.

A strategic position is a unique position, one that competitors do not occupy and hopefully cannot copy. As no company can be everything for everybody, choosing what not to do is as important
as choosing what to do. Because of the threat of imitation it is vital that companies make tradeoffs, defined as "incompatibilities between strategic positions that create the need for choice". Sources of such incompatibilities are:

1. Incompatible product and service attributes
2. Differences in the best configuration of activities in the value chain
3. Inconsistencies in image
4. Limits on internal coordination, measurement, motivation, and control

Furthermore, strategy is also about creating fit among a company's activities. The best fit occurs when mutually reinforcing activities are combined. If cost of performing one activity is lowered because of the manner in which other activities are performed, then fit exists. This can ensure that companies keep their position by making a whole chain of activities hard to imitate.

1.2.6. Supply Chain Management and logistics

Highlight the importance of tailoring logistics to each company's distinct strategy. They outline three different retail strategies: "fast-to-market", "waves of fresh assortment", and "low cost". A product flow comparison with strategies that is declared to be drawn from how successful retailers have configured their supply chains.
### TABLE 1.3: PRODUCT FLOW COMPARISON

<table>
<thead>
<tr>
<th>Description</th>
<th>Fast to market</th>
<th>Waves of fresh assortment</th>
<th>Low cost</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Manufacturer cost</strong></td>
<td>Trade off some cost for speed and flexibility</td>
<td>Live with longer lead times in order to drive lower purchase cost</td>
<td>Drive lowest purchase cost and off-load as much work as possible to manufacturers</td>
</tr>
<tr>
<td><strong>Transportation from manufacturer to distribution centre (DC)</strong></td>
<td>Frequently use highest cost transportation mode (airfreight) to gain speed</td>
<td>Balance speed and cost using low cost transportation mode to small number of regional DCs</td>
<td>Maximize use of transportation modes by establishing many local DCs close to stores</td>
</tr>
<tr>
<td><strong>Distribution centre cost</strong></td>
<td>Look for speed</td>
<td>Balance speed and cost in handling new product waves</td>
<td>Operate DCs to minimize work done in stores</td>
</tr>
<tr>
<td><strong>Transportation from distribution centre to store</strong></td>
<td>Small, fast, and expensive store deliveries</td>
<td>More cost effective small store deliveries</td>
<td>Most cost effective full truckload delivery to stores</td>
</tr>
<tr>
<td><strong>Store operation</strong></td>
<td><strong>Full service</strong></td>
<td><strong>Full service</strong></td>
<td><strong>Self service</strong></td>
</tr>
</tbody>
</table>

### 1.2.7. SCM Practices

Concepts as supply strategy rely on balancing within a network: In Harland et al's Delphi-study an outcome was that:

"The role for managers appears to be a more dynamic balancing act, maintaining their own organisation's viability and prosperity, within a much more complex network, the survival and success of
which are of critical importance to its constituent firms." (p. 669 Harland et al. 1999)

The supply chain is defined here as a part of a network that supplies a specific product from raw material to final customer - it is a whole commercial chain embedded in the network (Hertz 2001) with a common objective of efficiency and effectiveness. Efficiency is an internal standard of performance while effectiveness is an external standard of fit to various groups' demands (Pfeffer and Salancik 1978).

Efficiency is a cost-related advantage and effectiveness is an advantage of customer-responsiveness within supply chain management research. This means that efficiency improvements are achieved through Just-in-Time production and logistic supplier nets while effectiveness are achieved through customer orientation (Moller and Torronen 2003). The value concept are related to efficiency and effectiveness (Forsstrom 2003; Fredriksson and Gadde 2003; Hakansson and Prenkert 2004; Moller and Torronen 2003). Value is defined as perception of monetary as well as non-monetary outcome where value creation is a set of direct and indirect relationship functions (Walter et al. 2001).
1.2.8. SCM Effectiveness

Organizational effectiveness is defined as an external standard "of how well an organization is meeting the demands of the various groups and organizations that are concerned with its activities" (p. 11 Pfeffer and Salancik 1978) which approximately is a construct "for doing the right things" or having validity of outcome (Hines et al. 2000). A conceptualization of effectiveness as use value is interesting to highlight that how well as well as demands in the above definition is vague. Hakansson and Prenkert (2004) seem to refer use value to evaluation of the network's utilization of resources. In resource dependence perspective is effectiveness seen as an independent measure for evaluating organizations. Meeting demands of various evaluators means that conflicting as well as compatible demands are prevalent. Pfeffer and Salancik (2003) foresee conflict when one stakeholder's demand constraints other stakeholder's demand, which is the case for the supply chain actors. Conflict but also co-operation gives "lesson's learnt" in one exchange process that is leveraged in other exchange processes. The evaluators we are concerned with are customers; customers seen in the producing/using activity system as well as in the networking activity system. Suppliers are effective if they deliver what is asked for, no matter if they are bound to fill their warehouses to manage, i.e. if they manage the task inefficiently. In supply chain management research is effectiveness equalized with
supply chains' flexibility and agility to customer demand. Ineffective supply chains are loosely integrated with poor management of existing interdependencies.

Effectiveness is by definition a qualitative measure set by evaluator. Moller and Torronen (2003) argue that effectiveness "refers to an actor's ability to invent and produce solutions that provide more value to markets (customers) than existing offers" (p. 112). This definition seems to equalize effectiveness to entrepreneurial activity as the ability to invent new solutions with added value is emphasized. In a supply chain context seems this definition to be counterproductive as it is based on an assumption that relationships are compared to competitors offers rather than evaluated in relation to customer's and their customers' demand. In practice is the evaluator, who is interdependent with the supplier, influenced by the relationship, by the supply chain and by the network. Effectiveness is created in a relationship in a process of attention to different interdependencies, i.e. the evaluator is influenced in its evaluation. We would propose that effectiveness, as a use value in a supply chain, is a combination of indirect benefits gained through the supplier and the supplier network (Walter et al. 2001). Ineffectiveness is an experienced misfit of resources in a resource pattern. This means that existing problems might be overlooked and that a relationship is evaluated as effective as long
as there is potential of the exchange system to fulfill demands. It means also that effectiveness is goal oriented on a strategic level (Liljegren 1988). The effectiveness is a co-created measure that is changed due to an increase in demand or a strategic change rather than regularly in short-term intervals. In these occurrences buyers evaluate the fit between supplier capability and buyers' need. Table below summarizes the main implications by using efficiency and effectiveness in a supply chain.

1.3. The Present Study
Due to the purchasing power that comes with control over consumer contacts, retailers are often dominant in a supply chain. Closeness to end consumer markets gives retailers fast and precise information about matters such as shifting fashion preferences and attractiveness of competitor's offerings, comparable to continuous market research. Even though power is no end in itself, it does include the opportunity to organize the supply chain in a suitable way. Many challenges face retailers today. Expanding product variety, greater fluctuations in demand, and shorter and shorter product life cycles make time-to-market reductions essential. The ever-increasing need for reduced lead times continues. Maximum coordination of work in and between companies is therefore necessary, as otherwise it will lead to higher costs as well as to longer lead times.
<table>
<thead>
<tr>
<th><strong>TABLE 1.4: EFFICIENCY AND EFFECTIVENESS AS VALUE CREATION PROCESSES</strong></th>
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<tbody>
<tr>
<td><strong>Activity outcome</strong></td>
</tr>
<tr>
<td><strong>Efficiency</strong></td>
</tr>
<tr>
<td>Value creation process</td>
</tr>
<tr>
<td>Focus</td>
</tr>
<tr>
<td>Activities</td>
</tr>
<tr>
<td>Boundary</td>
</tr>
<tr>
<td>Measures</td>
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</table>

There is however no single best way to manage a supply chain; the way retailers compete in consumer markets influence what should be focused on. As no company can be everything for everyone, there is interdependence between what a company sets out to be for a consumer, i.e. the company's value proposition, and that company's supply chain.
A value proposition concerns how, where, and when a company creates value for its customers, and that all activities - from product development to order fulfillment - should be based upon it.

In supply chain management research is effectiveness equalized with supply chains’ flexibility and agility to customer demand. Ineffective supply chains are loosely integrated with poor management of existing interdependencies. The roles performed by the Supply chains in FMCG can only be understood from the perspective of how the supply chain system itself is effective.

The present study has four fold-purposes. Firstly, it will assess the role of supply chain in the form of various supply chain practices i) agreed and ii) adopted by the FMCG companies. Secondly, it will explore how such practices are varied across various types of outlets under study. Thirdly, it will assess and analyze the effectiveness of supply chain practices, and

Lastly, it will analyse effectiveness of supply chain practices in relation to various types of outlets.
1.4. Research Questions

1. How do supply chain management practices vary across types of retail outlets?
2. How do supply chain management practices vary according to the designation of the functionaries of SCM?
3. How effective are supply chain management practices across types of retail outlets?
4. How effective are supply chain management practices perceived by SCM functionaries according to their designations?
5. How do SCM practices influence effectiveness of SCM?

1.5. The Objectives

1. To assess the supply chain management in FMCG sector perceived by the managers responsible for SCM
2. To assess the effectiveness of supply chain management as perceived by the SCM functionaries.
3. To analyse the variations in the roles of supply chain according to various types of outlets
4. To analyse the variations in the roles and effectiveness of supply chain management according to the designation of the SCM functionaries.
5. To analyse the variations in the effectiveness of supply chains according to various types of outlets.

6. To examine the relationships between the roles of supply chain and the effectiveness of SCM as perceived by the SCM functionaries.

1.6. The Summary

Under this chapter a detailed note on the statement of the problem has been presented which highlighting the importance of understanding Supply Chain Management practices in retail industry.

Various issues relating to Supply Chain Management practices and its effectiveness have been highlights in order to understand the need for conducting such study. Supply Chain Management agreement and adoption related practices and Supply Chain Management effectiveness have been identified as the centrality in this study.