

SCALA

The UK Logistics Report

Grocery and FMCG Sector

2018



Introduction

Logistics provides one of the essential infrastructures upon which UK commerce is based. A force of 1.8 million people who work day and night to ensure businesses can meet their promises to customers. In recent years, this crucial sector has coped with unprecedented levels of change. It has needed to adapt to the growth of online retail, rising fuel costs, rising wage costs, an increased focus on environmental impact, and ever demanding customers.

This pace of change shows no sign of relenting, with the uncertainties of Brexit also being thrown into the mix. For those responsible for keeping our country moving, it has never been more crucial to have detailed data and evidence at your fingertips.

Our UK Logistics Report on the Grocery Sector

It is for this reason that we have decided to publish our **UK Logistics Report** for the first time. This report is based on a benchmarking exercise that SCALA has carried out annually for the last 15 years. This version focuses on the Grocery and FMCG sector, and its findings and trends are based on data from the UK's major manufacturers.

We believe it provides unrivalled insight into the current state of logistics, as well as clues as to how the sector can best respond to future challenges. In this report, we will show the trends that have been emerging over time and use these to highlight issues in areas that should be key for future development.



About SCALA

SCALA is a leading international consultancy based in the UK, which specialises in procurement, supply chain, logistics and customer service, and provides independent and objective expertise. We have gained an excellent reputation working with major clients in the Grocery and FMCG sectors to drive supply chain improvements, deliver business benefits and enable business strategies and objectives to be successfully achieved.

SCALA has an experienced, knowledgeable and passionate team, whose approach is to work in partnership with our clients. It combines external knowledge, expertise and innovation with clients' own business understanding to deliver solutions agreed by the whole team. SCALA manages a number of supply chain best practice forums for leading companies and leaders in benchmarking service and performance. Alongside its headquarters in the UK, SCALA also has offices near Shanghai in China.



PROCUREMENT

Strategic Product Sourcing - Vendor Performance Management - Negotiation Training - Cost Reduction Strategic Manufacturing



SUPPLY CHAIN

Demand Driven Supply Chain - Sales and Operations Planning - Supply Chain Planning - Customer Service



LOGISTICS

Outsourced Logistics - Logistics Network Design - Transport Optimisation - Warehouse and DC Design



BEST PRACTICE

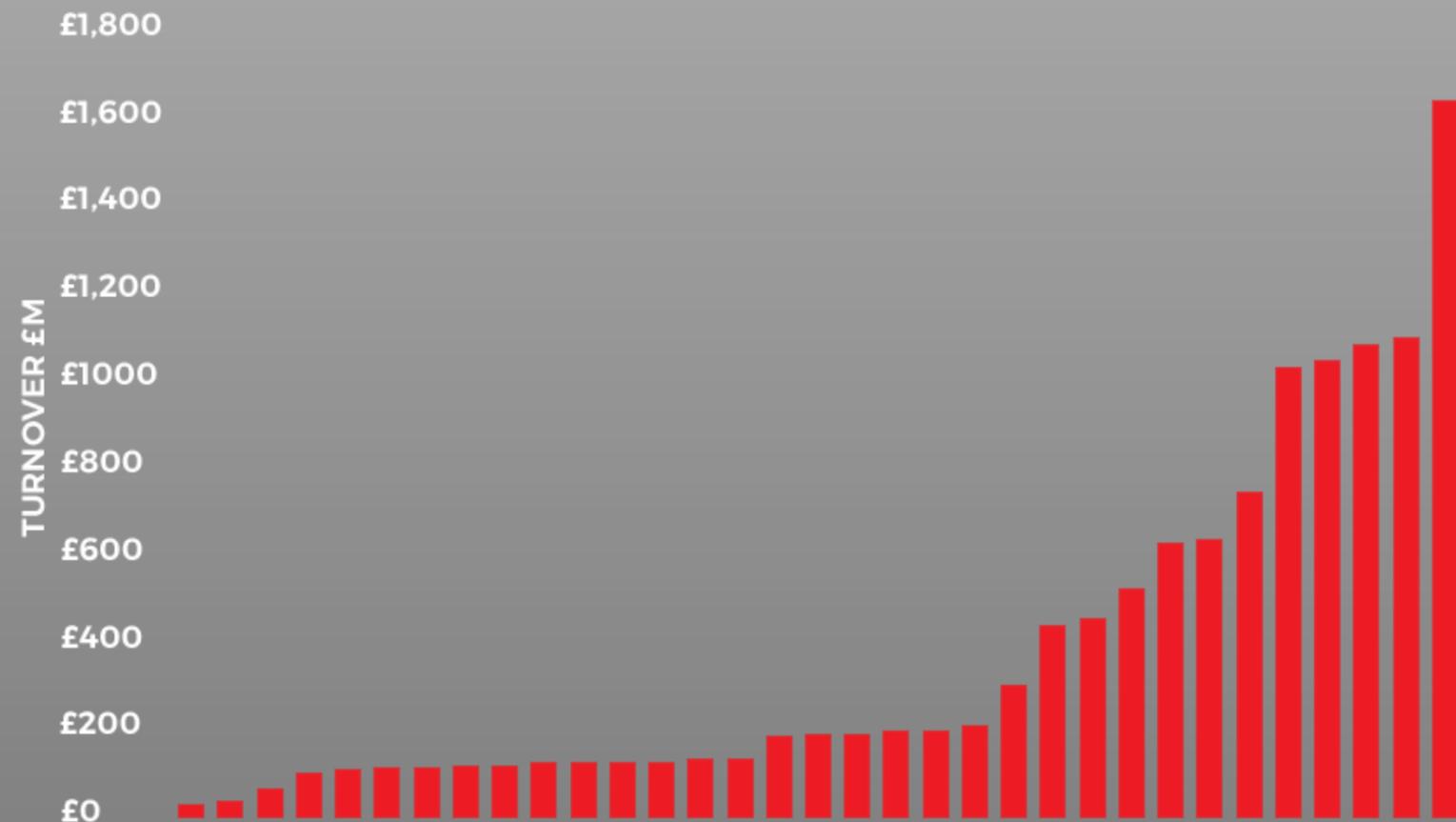
Grocery and FMCG Best Practice - Home Appliance Best Practice - Retailer Best Practice - Cost and Service Performance Benchmarking

Benchmarking Process

Best Practice, Learning, and Collaboration

This report combines these data points to provide a picture of the sector as a whole and how it is changing (looking back at comparable data over the last decade where possible). Over the past 15 years, we have maintained highly precise sector analysis and tracking, enabling us to look for patterns and trends that help us and our clients learn from the past and shape the future.

Organisations that wish to benefit can get involved through our Best Practice Forums, which operate throughout the year. Each are attended by major manufacturers and retailers to share best practice, learn and collaborate. These currently operate within the Grocery and FMCG, Home Appliances and Retail sectors, as well as on shared topics, such as cost and service performance benchmarking.



a graph taken from SCALA's Benchmarking, detailing the annual UK turnover of many leading UK Grocery and FMCG companies



40

KPIs across sourcing, cost, volume, product



16

of the largest UK grocery manufacturers



£10.3bn

combined turnover of participating companies

The Current State of Logistics in the Grocery and FMCG Sector

The intense pressures on profit margins across the sector are evidenced in the performance of logistics teams over the last twelve years. Despite many upward pressures on costs (especially fuel), logistics costs as a percentage of sales actually fell overall in 2017 (from 5.8% to 5.3%).

This highlights consistent efforts to improve cost performance, in particular across both warehousing and transport. This pressure to drive further cost efficiencies is unlikely to let up any time soon, remaining a key focus for the sector.

From analysing the data, there are some key areas where these cost savings have been achieved.



fuel prices

UP

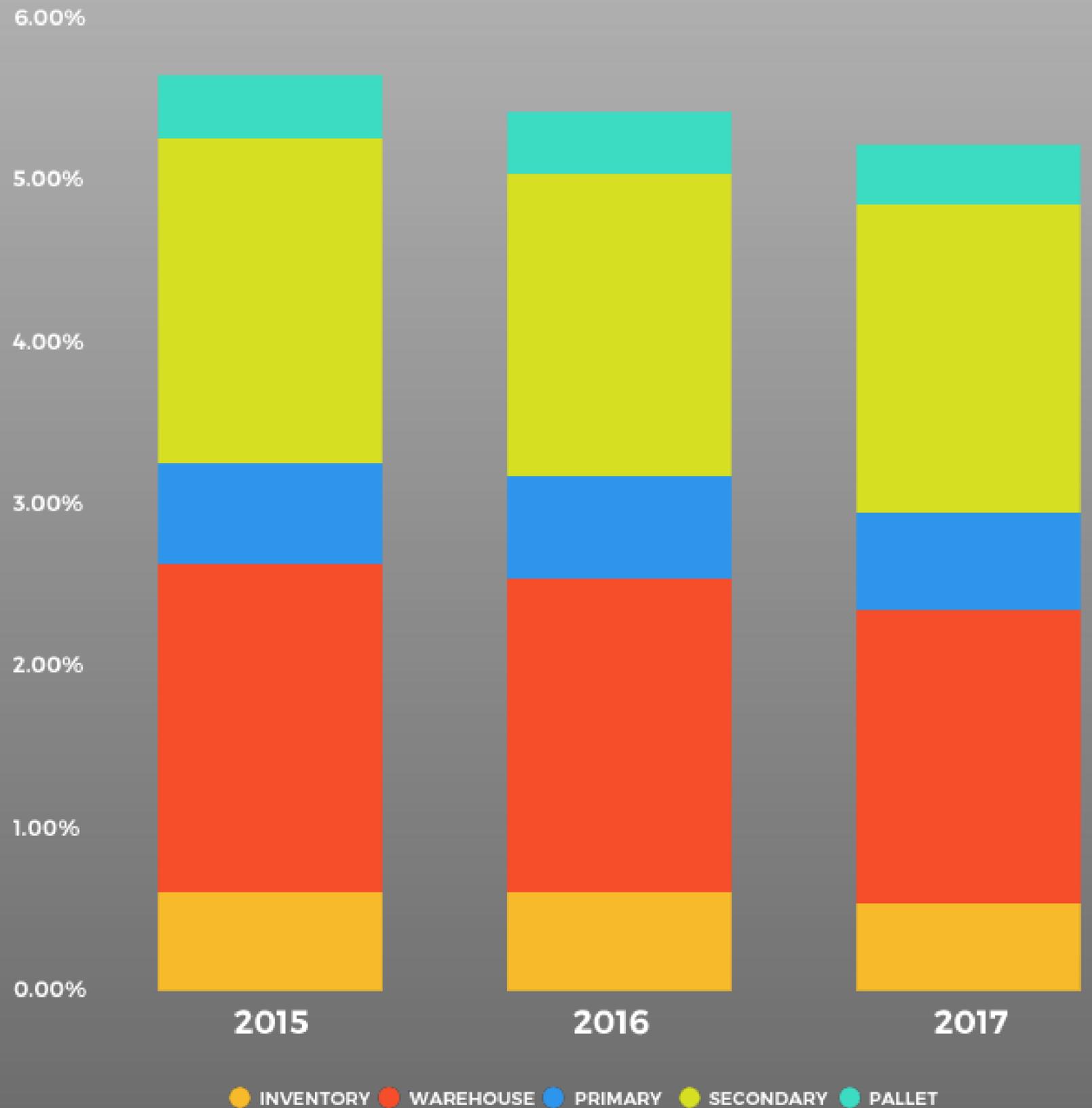


logistics costs

DOWN



**IMPROVED
OPERATIONAL
EFFICIENCY**



The Current State of Logistics in the Grocery and FMCG Sector

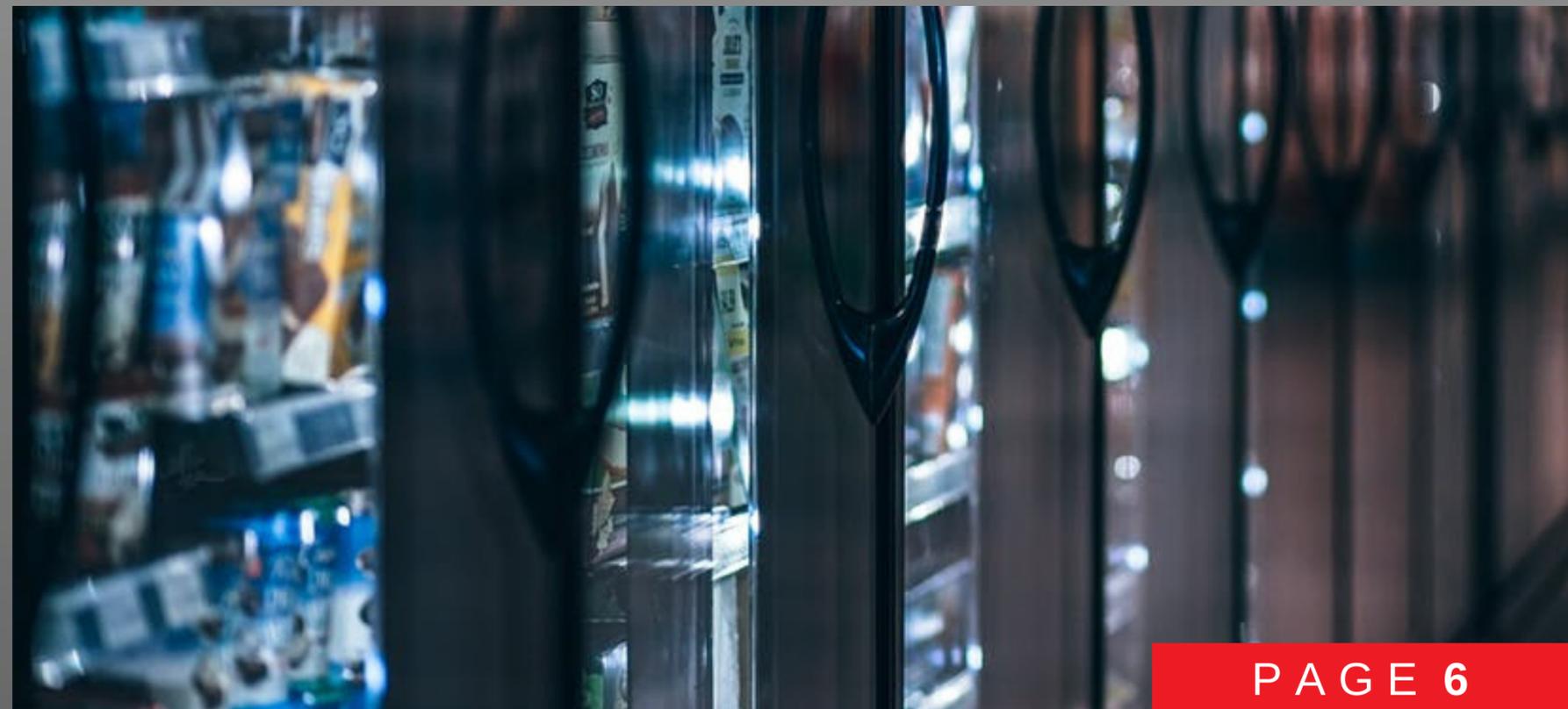


Reducing external storage

There has been a notable switch away from the use of external storage. By investing in their facilities, manufacturers have been working to expand their capacity or make better use of the space they have. This has not only led to a reduction in storage costs, but also in costs associated with the movement of stock, management of transport and management of customer order size. SCALA has completed several projects recently to improve warehouse utilisation, review inventory levels and assess contributory factors. One particular example known to SCALA focused on the reduction of SKU ranges to simplify manufacturing and allow more storage space for core SKUs.

Increasing average order sizes

As shoppers continue to move to 'little and often' purchasing of Grocery and FMCG products, you would expect order sizes within the supply chain to reflect this trend. However, average order sizes have increased by an average of 5.6% since 2015. The UK's major multiple grocery retailers have recognised that the capacity in their networks can help drive additional savings. As a result, retailers are increasingly open to negotiating over order sizes, enabling manufacturers to benefit from greater cost efficiencies and share these savings with retailers.



The Current State of Logistics in the Grocery and FMCG Sector



Business Profile and Volumes by Sector

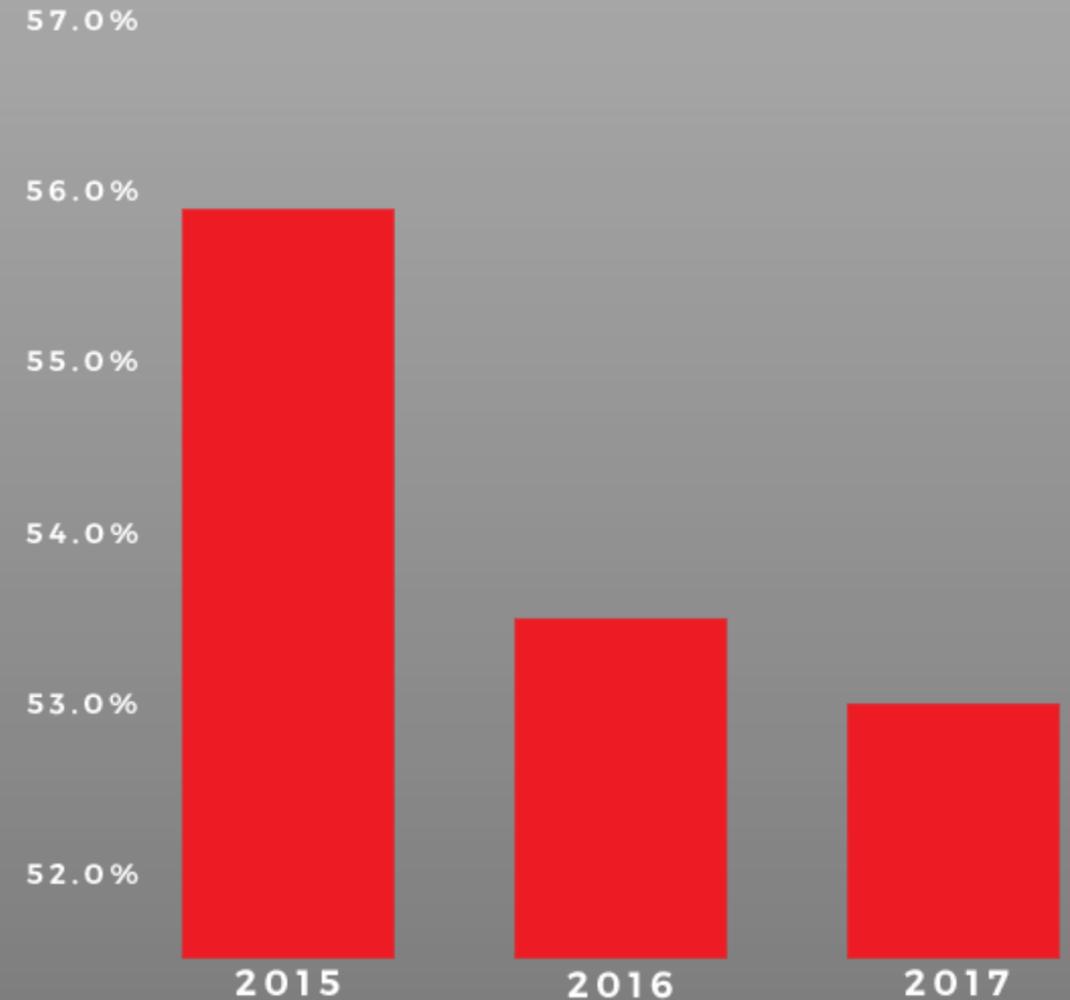
Trends within the data are also highlighting an evolution in the nature of the grocery sector. The 'traditional' major multiple retailers remain the dominant force in the sector, just over 52% of the total volumes delivered. However, their position is being eroded and this is having major implications within logistics.



An Evolving Landscape

The traditional major retailers share of product volumes has continued to decline in recent years, with volumes down nearly 5% since 2015. Their volumes are being eroded by the continued growth of discount and convenience retailers - IGD estimates that discount retailers will see a 49.8% increase by value over the next five years (compared to just 5.9% for traditional supermarkets). This is being driven partly by expansion, with new stores added to growing networks, and innovations to improve shopper experience and create a greater variety of stores. Convenience stores too are expected to see healthy growth in value (17.7% by 2022), leveraging their appeal to younger shoppers and those looking for food-on-the-go.

a graph taken from SCALA's Benchmarking, illustrating the changes in volume to majors (Tesco, ASDA, JS, Morrisons) over the past 3 years.



The Current State of Logistics in the Grocery and FMCG Sector



Implications for Logistics

This ongoing trend will have serious implications for Grocery and FMCG logistics. Companies that operate in this sector will be required to deal with a larger network of smaller retailers. However, some discount retailers are already operating a centralised approach whereby all volume from a supplier is delivered to a single location - effectively a consolidation point for onward distribution. The convenience inevitably comes at a cost to the supplier, the task then being to assess the cost against the benefit (and against own cost to serve).

Product Range, Rationalisation, and Expansion

Logistics data suggests that product range management is going to become an increasingly difficult challenge. Average SKU count will reduce by 10% for Grocery suppliers, owing to instore rationalisation and reduced demand for promotional SKUs as offers focus on incentivising existing lines. We are seeing significant range rationalisation within certain retailers, though this is often reported as an attempt by traditional retailers to mirror the simpler and more streamlined approach of their discount challengers. For example, Kantar reports that the typical discount retailer has 7,500 SKUs, compared to 30,000 for a traditional supermarket. This situation is already changing. Tesco, for example, announced that as part of its Project Reset, it would remove as much as 30% of its product lines.



The Current State of Logistics in the Grocery and FMCG Sector



Range Expansion

However, things are rarely that simple. Alongside areas of rationalisation, we are also seeing some product ranges being expanded. Discounters, for example, are seeking to increase their appeal by increasing variety (albeit remaining at a much lower level than their traditional counterparts). Traditional retailers too are not simply looking at rationalisation. In some areas they are seeking to increase choice and innovation.

Pack sizes are one example, where retailers are looking to provide more choice with a 'personalised' selection for different types of customer – e.g. from solo shoppers to bulk-buy bargain hunters. This is especially true for discount, convenience and online channels.

There is also a notable drive for innovation, in an attempt to keep shoppers interested and build reputation and loyalty by being first with the latest trends.

The Current State of Logistics in the Grocery and FMCG Sector



The Logistics Challenge

Such a period of flux gives logistics a significant challenge. How best to respond to constant change, managing both rationalisation and expansion (especially in pack sizes) within the same sector? Thinking ahead and weighing up the implications of different solutions will be crucial. Whether to outsource, manage in-house, automate and at what point in the supply chain?

PACK
SIZES



SECTOR
EXPANSION



OUTSOURCING
& AUTOMATION



The Current State of Logistics in the Grocery and FMCG Sector



Delivery Points

A key factor that has enabled logistics to manage its impact on costs is that, despite the growth of discounter networks, there has yet to be a significant increase in the number of delivery points for Grocery and FMCG manufacturers.

This is, in part, due to discounters remaining a relatively small part of the sector (albeit one that is growing quickly). It is also the result of the unique nature of the sector's online channel. Although online shopping is an increasingly important aspect of grocery retail, for manufacturers little has changed. They are still delivering the same product to the same delivery points – with the retailers taking on the responsibility of home deliveries.

However, it is important to consider how long this situation is likely to persist. For example, with some retailers now operating very sophisticated fulfillment centres, how long will it be before manufacturers are expected to deliver 'online-ready' pack formats?



The Current State of Logistics in the Grocery and FMCG Sector



Sourcing

Another area where logistics is yet to see significant change is in the sourcing of products. The data shows no significant trends in either the geographical sourcing of products or the balance between in-house and co-manufacturing. Clearly, this is one area that may change dramatically once the nature of Brexit is made clearer. The full impact of changes to exchange rates in late 2016 are yet to fully play out in the sourcing and movement of grocery products.

This is especially important for current movements across the Irish border. Over recent years, many manufacturers have created cost efficiencies by servicing Ireland through their UK networks. However, many are beginning to plan for alternative scenarios depending on what solution is agreed for cross-border trade and whether Ireland will have special status in the final Brexit agreement.



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The UK Logistics Report

Key Conclusions



Key Conclusions

The pressure to protect profit margins has largely been carried on the shoulders of the logistics sector – but the pressure to become even more cost-effective is unlikely to let up soon and will continue to be a key focus for the industry. These efficiency savings are being made in a number of areas:

- Moving away from external storage to utilise existing warehouse space, perhaps by reviewing inventories and allowing more storage space for core SKUs.
- Increasing average order sizes by negotiating with retailers over order sizes to enable greater efficiencies on both sides. Average order size increased by 5.6% since 2015 (cases per order).
- While major retailers remain the dominant force in the sector, discounters are catching up, driven by a demand for convenience. This ultimately will come at a cost to suppliers, therefore they must assess their cost to serve.
- Major retailers are opting to reduce their ranges in search of a streamlined approach, while discounters are seeking to increase their appeal with the offer of more variety. Thinking ahead and weighing up the implications of different solutions will be crucial to the supply chain.



Key Conclusions



But, the future is only likely to bring with it an array of additional challenges that the logistics sector must respond to:

- With the growth of online shopping, and the discounter retailers, the number of delivery points that manufacturers have to service may change. Will retailers soon expect the delivery of 'online-ready' packs?
- With the UK's official exit of the EU drawing nearer, will we see a significant change to the sourcing and movement of products? Irish shipping companies are already anticipating major border disruptions and are looking to relocate their logistics operations to bypass the UK altogether.
- Logistics businesses need to give serious thought to their Brexit contingency plans to ensure they're prepared for any changes that may be introduced come March 2019.



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