

# Woolworths Plc

## Sourcing Retail Merchandise from South East Asia

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# Woolworths Plc

## Modal Choice Decisions in International Transport

*By David Taylor & Brian Shortland*

### Introduction

In October 1993, Brian Shortland of Woolworths plc was considering the results of a 12 month project in which he had reviewed the supply chain systems operated by the company for sourcing merchandise from South East Asia. It was clear that a major overhaul of the company's operation was required and he was contemplating how best to present the results of his review and his recommendations for improvements to the next Woolworths' Board Meeting which would be held in ten weeks time.

### Company Background

Woolworths plc is a major retailer in Britain with some 800 outlets in the UK. The first store was opened in Liverpool England in 1909 by the F.W. Woolworth organisation of the United States of America. The company under the F.W.W title was, by 1980, operating from 795 stores in all the major cities and towns in Britain. However in 1982 the UK operation was bought from the American parent company by Kingfisher, a British consortium.

The main focus of the company is directed at young families with children. Five main product ranges are carried in store, which are: - Toys; Children's Clothing; Entertainment (compact discs, tapes, videos); Confectionery; and Home & Kitchen. Merchandise is priced in the low to medium range thus supporting the main customer base and within the United Kingdom. Woolworths has a strong position in the market place as is shown in Exhibit One.

### Exhibit One

#### Woolworths Market Position within the UK by Value of Sales 1993

TOYS	2nd place
CHILDREN'S CLOTHING	2nd place
ENTERTAINMENT	1st place
CONFECTIONERY	1st place
HOME & KITCHEN	N/A

In 1993, some 33% of the merchandise sold, approximately £500,000,000 (Sterling) at selling price, was manufactured in Asia of which approximately £330,000,000 was purchased from UK importers and £170,000,000 was purchased direct from the Far East. This volume of merchandise entailed shipping some 3,500 TEU's (twenty foot equivalent container units), which made the company the largest importer by volume in the UK retail trade.

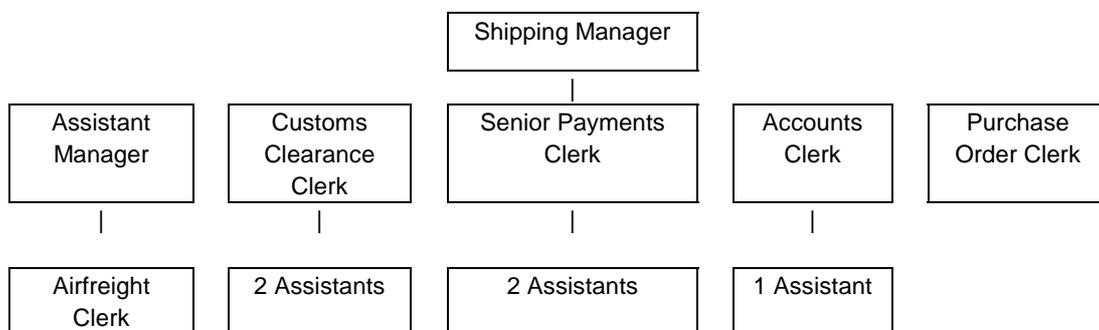
## The Importing Process

Woolworths operated a Shipping Department, based at the London headquarters, to handle the order processing, customs clearance and payment for merchandise imported directly from overseas suppliers. Most merchandise was bought on C&F (Cost and Freight) terms from suppliers. Payment was in the main on the basis of 'Documents against Payment at sight' (D/P), with some Letters of Credit's opened when certain suppliers insisted. (See Appendix One for details of terms of trade)

There was very little co-ordination between the company's 25 merchandise buyers and the shipping department. Furthermore the buyers each independently arranged their own currency requirements from the company's central finance department in London, but there was no central control or reconciliation of the large number of currency contracts placed.

### Exhibit Two

#### Structure of the Shipping Department



The shipping department was struggling to keep control of the situation and a number of problems were causing concern to senior management. The department was handling some 6000 sets of shipping/bank documents per annum and preparing the same number of HMC&E (Her Majesty's Customs and Excise) declarations in order to clear goods for importing. The staff were knowledgeable and keen but had no authority to change company policy on importing nor to challenge the Buying function on the methods and practices they used.

The documentation procedure in place at this time was as follows: -

When buyers returned from their Far East sourcing trips, handwritten purchase orders were passed from the buying departments to the Shipping Department. This was because merchandise was purchased in various currencies and no systems within the organization could handle currencies other than Sterling, so import purchase orders could not be produced via the company's computerised purchase order management system.

Once received by the Shipping Department purchase orders were checked as to:

- Latest shipment date
- Payment terms
- Correct country of origin
- Correct currency
- Supplier details
- Customs tariff classification

When checking and verification were complete, the import purchase order with shipping instructions would be mailed to the supplier. Where payment terms were by Letter of Credit, the application form would be completed manually and submitted to the company's bank in London. The bank would then issue the Letter of Credit to the supplier.

Once merchandise had been shipped from the port of export and bills of lading issued by the shipping company, the supplier would complete the various export documents. They would present the originals to their bank for onward transmission to Woolworths' bankers in the UK and at the same time send copy documents to the Woolworths Shipping Department.

Documents were received by Woolworths in London from their bank (on trust for 24 hours). These were then checked against the import purchase order and, if satisfactory, the bank was advised to pay the relevant Bill of Exchange if payment terms were D/P, or to accept the Bill of Exchange if terms were D/A. (see Appendix One for explanation). It is important to note that until the shipping documents were released to the importer by the bank, the importer had no 'Title' to the goods.

Declarations to HMC&E were then manually completed, which entailed copying all the relevant details of the consignment onto an official HMC&E "Customs Declaration" set of forms. The information required by HMC&E for each consignment of imported merchandise was:

- Name of vessel
- Arrival date at UK port
- Name of UK port
- Description of goods
- HMC&E tariff
- Quantity of goods (numeric)
- Quantity of goods (weight)
- Value of goods in currency of invoice
- Value of goods in sterling (conversion rate is set each period by HMC&E)
- Cost of freight
- Duty payable (duty is payable on "Landed Cost" i.e. cost of goods + ocean freight + insurance).
- Country of origin
- Insurance cost

The HMC&E declaration was then sent to Woolworths' customs clearing agents at the port of import. They would present the declarations with invoices, packing lists and GSP Certificate of Origin, for the goods to be cleared for import. This process took between five days and two weeks.

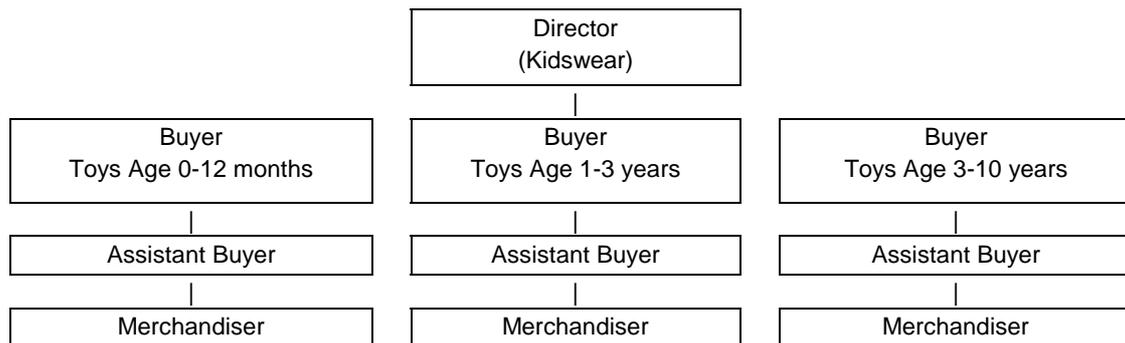
Once the goods were cleared by customs, merchandise would then be booked by the clearing agents for delivery from the port of import to the relevant Woolworths distribution centre (DC) in the UK. The company had two distribution centres, one in Swindon to serve the south and the other in Rochdale to serve the north of the country. Upon receipt at the DC, merchandise would be checked for quality against the standards set by the Woolworths Quality Assurance Department. If acceptable, it would be issued to stores; if not, it would be held for return to the supplier.

## The Operation of the Buying Department

The company had three main merchandise divisions (Toys; Home Essentials and Kidswear) which all imported on a direct basis. Each division had a divisional director and a number of buying teams, which specialised in various lines within the product range for the division (see Exhibit Three). The main processes in the company's buying cycle are shown in Exhibit Four.

### Exhibit Three

#### Typical Divisional Buying Structure:



### Exhibit Four

#### The Buying Cycle

Range Planning (Step 1)	Sourcing of potential suppliers (2)	Selection of preferred suppliers (3)	Samples received from suppliers (4)	Buying Decision (5)	Purchase Order Placed (6)
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Goods ready for shipment from supplier (7)	Goods on Board Vessel (8)	Vessel Departs Port of Export (9)	Vessel Arrives UK Port (10)	Documents Received from Bank (11)	HMC&E Declaration completed by Woolworths UK (12)
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HMC&E Declaration Presented to Customs (13)	Goods Cleared for Import (14)	Bill of Lading presented to Shipping line for Release of Goods (15)	Goods Booked into Woolworths Distribution Centre (16)
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The buying cycle lead times varied for each division:

**a) Children's Clothing would typically be:**

Buyers visit Far East - October/November

Orders Placed - January

Delivery in UK - August / September

**b) Toys would typically be:**

Buyers visit Far East - September / October

Orders Placed - January

Delivery in UK - May / June (for July sales promotion)

Woolworths, like many other retailers considered efficient purchasing to be at the heart of successful retailing. As a consequence, the Buying function was a particularly influential department within the company and was responsible for all purchasing activities from range planning and demand forecasting, through to placing the purchase orders and the specification of product volumes and delivery schedules. As one of the main elements in Woolworths' market position was price competitiveness, a key objective for the buyers was to minimise unit purchase price and as a consequence, the primary measure used to evaluate the effectiveness of buying was the gross margin. This was the estimated selling price of the product minus its landed cost at the 'back door' of the UK distribution centre (the latter being the price quoted by suppliers on a C+F basis).

On the whole, the buyers were very successful at meeting the gross margin objective because of their experience and expertise in negotiating and because the volumes required meant they usually had considerable purchasing power with suppliers. They would also order bulk quantities in order to receive further discounts and achieve economies in transportation costs. Most buyers had considerable experience in the business and had progressed to positions in buying through either the retailing or merchandising functions of the company. Buyers would pride themselves on their knowledge of the market and would be confident in their judgments about what would or would not sell and of the quantities that would be required for a particular season or period.

Buyers often made decisions on product selections, required quantities and approximate selling price on the basis of their 'feel for the market'. In practice, this required considerable skill but did entail some risk, particularly as Woolworths did not have an EPOS system in place in the stores and therefore had little in the way of computerised data on past sales from which to forecast demand. A further factor adding risk in purchasing was the fact that many of Woolworths products were either fashion items such as toys and clothing, or highly seasonal items such as garden furniture, the demand for which was notoriously difficult to predict. Such risks were exacerbated when merchandise was sourced from distant suppliers because of long and variable lead times of supply, fluctuations in currency values and the requirement to predict volumes, place orders and purchase often a whole season's requirements in one order, usually well in advance of the selling period. The normal pattern in purchasing from SE Asia was to order the total quantity required for a season and for goods to be shipped in one bulk delivery or occasionally in phased shipments.

## Identifying Problems

As part of his investigation, Shortland held discussions with the following groups within the company, each of which had an involvement in the supply chain: -

- a) Buyers
- b) Merchandisers
- c) Shipping Department
- d) Finance Department
- e) Distribution Management

From these meetings a number of problem areas were highlighted by the managers within the respective sections

### Buyers

The buyers felt that one of the main problems lay with long lead times, particularly at the UK end of the supply chain. There was considerable uncertainty over the length of time taken between arrival of merchandise at the UK port and eventual clearance and delivery to the distribution centres. In practice this could vary between a few days and a few weeks and often resulted from delays due to documentation problems or customs procedures. Average port clearance time was about 2 to 2.5 weeks. In consequence buyers often added extra weeks to lead times to cover these periods. Of course this meant that those shipments which did clear the ports efficiently (e.g. in a few days) arrived at the distribution centres ahead of schedule and had to be stored for longer before distribution to the shops.

Buyers also expressed concern over the quality control system. In 1993 there was some £3.5 million owed to the company by major suppliers for faulty merchandise supplied over the previous 12 month's period.

The quality control system worked as follows:

Once a buyer had sourced a potential item, the supplier would be required to send samples for testing to the Quality Assurance Department at headquarters in London. For many items this testing would be extremely rigorous, particularly for children's toys, for which European Community safety standards were very stringent. If the product met the required standards, it would be approved and an order confirmed. Staff from the London QA department would also visit the Far East on a number of occasions each year to inspect the factories of suppliers. Once a factory was accepted an agreed quality monitoring system was put into place supervised by an external agency specialising in quality assurance management. However quite frequently suppliers would despatch shipments before the Q/A agency had inspected the goods.

When products were delivered to the UK distribution centres, a rigorous, random sampling procedure was carried out and if the samples taken failed to meet the required standards, the whole shipment would be rejected. It was not at all uncommon to find that the quality of delivered products was below that of the samples originally sent to HQ either in terms of materials used or quality of workmanship. Resulting disputes with suppliers were often difficult to resolve and the only real lever Woolworths had was to withhold payment, either against the current shipment, if payment had not been made, or against future orders, e.g.

when a letter of credit was involved.

### **Merchandisers**

The role of merchandisers was to provide an interface between the buyers, the UK distribution centres and the administrative departments including the shipping department. Whilst the role of the shipping department was to organise the documentation and customs clearance of imported goods and arrange for delivery from the port to the appropriate DC, the merchandisers administered the disposition of goods. This involved allocating stock to the appropriate DC, informing DC's as to when to expect deliveries from suppliers and determining delivery volumes and schedules from the DC's to the stores. Merchandisers often worked in partnership with an individual buyer and would check that when a buyer placed an order, there was sufficient quantity to give stock coverage for each store.

The main complaint of the merchandisers was the lack of control over merchandise shipment programmes. Firstly there was no control over when merchandise was actually shipped, which often led to merchandise being received late. Secondly as goods were normally purchased on C&F terms, the vendors supplied the merchandise, arranged the shipping and paid the freight, without any obligation to provide information about the vessel / shipping line used, or the date of departure from the port of export. Thus once an order was placed very little information was available until the shipping department received either the original documents from the bank or copy documents from the supplier. These were often received up to 5 weeks after merchandise was shipped from port of export by which time the goods had quite frequently arrived at the UK port.

### **Shipping Department**

The main problem here was that the department was working at full capacity to keep up with the flow of documents and in particular to complete the HMC & E declarations. The workload was such that there was a need to increase the number of staff employed.

### **Finance Department**

The company's finance managers considered there was a serious risk element within the currency purchasing procedure. The finance department responded to the demands of the buyers. Each buyer independently ordered foreign currency to suit their own purchasing requirements and there was little overall control of the amounts purchased or the timing of purchases. Thus substantial deposits of foreign currencies were held by the company with the risk of losses being incurred if Sterling weakened.

### **Distribution Management**

Managers of the company's two DC's voiced two main concerns: -.

Firstly they were unaware of merchandise on order, or of delivery schedules until they received information from merchandisers about when goods were booked for receipt at the DC's. Often this was only a matter of weeks or even days before delivery, which meant planning of manpower and other resources within the DC's was difficult.

Secondly if the volumes of merchandise purchased proved to be in excess of the amount sold in a particular season, the DC's were left holding the excess stock, sometimes for a whole

year, until the next selling period. This could create problems of congestion in the warehouses and also added costs in excess of warehouse budgets. Warehouse managers resented these costs as they felt they arose as a result of inefficiencies in the buying process rather than from inefficiencies in the warehouse. Buyers were charged a fee for warehousing and distribution which was offset against their gross margin calculation.

This distribution fee was calculated by allocating budgeted distribution costs on the basis of the proportion of total throughput accounted for by each line, but it did not include the cost of any long term stocking of over-ordered lines, nor the cost of collecting and re-warehousing unsold stock from stores. Neither did it include any allowance for the cost of capital tied up in inventory. The latter cost was considered as part of the company's general overhead and was another issue of concern frequently raised by the finance department. On average stock held by the company was in the order of £250 - £300 million with the bulk held in stores, either on display (approx. 50%) or in back-of-store stock rooms (approx. 40%) and the rest held in the DC's (approx. 10%).

### **The Need For Change**

Although the company's senior management did not have detailed knowledge of the day to day operations of the Far East supply chain, they had recognised there were problems and hence had appointed Shortland to review and improve the situation. Following his investigations, Shortland had a much clearer picture of the various operational difficulties that existed, however one area in which he had not found much information was in relation to the costs of operating the supply chain system. This was partly because these costs were split between various departments within Woolworths and also because a significant portion of the logistics costs were hidden in the C+F prices quoted by the majority of suppliers. Although he did not know the costs involved even in the delivery of product from suppliers into the DC's, his 'gut feeling' was that the delivery costs alone might account for anything up to 15% of the C+F price. If this was the case, he was confident there was scope for considerable saving.

## APPENDIX ONE

### GLOSSARY OF TERMS

TERM	DESCRIPTION
<b>Shipping Terms</b>	
TEU	A count used in container shipping.  One TEU equals one twenty-foot container.
FEU	One FEU equals one forty-foot container.
<b><u>Buying Terms</u></b>	
C & F (Cost and Freight)	The vendor quotes for supplying the merchandise, arranging shipment and paying the freight costs to a specific destination.
C.I.F. (Cost Insurance and Freight)	The vendor quotes for supplying the merchandise, arranging shipment, insuring the cargo, and paying the freight costs to a specific destination.
F.O.B. (Free on Board)	The vendor quotes for supplying the merchandise and for all landside costs up to loading the cargo on board the ship. The buyer pays the freight costs.
<b><u>Documents</u></b>	
B/L(Bill of Lading)	When cargo is placed on board a vessel the B/L is given by the shipping line to the owner of the cargo (The Shipper). This document is issued as a set, comprising 3 originals, which are signed by the shipping line or their agents, and 3 copies which are unsigned. Possession of an original of this document gives TITLE to the cargo. This document is also a receipt for the cargo.
Invoice	The document giving details of the merchandise sold, with description, price and quantity.
Packing Advice	Document giving details of No. of cartons, carton no's, marks and measurements and weights.
GSP Certificate	Document issued in the country of export to support a claim that the merchandise is within the GSP (General System of Preferences) enabling less or nil duty to be payable in the country of import.
Certificate of Origin	Document issued in the exporting country stating the origin of the goods.
<b><u>Payment Terms</u></b>	
Letter of Credit (L/C)	This method of payment gives safeguards to both the vendor and the buyer. A Letter of Credit is issued by the buyer's (Applicant's) bank (Issuing Bank) via the vendor's bank (Advising Bank) to the Vendor (Beneficiary). The L/C is a bank guarantee that the Issuing Bank will make payment, or accept and pay Bills of Exchange drawn by the Beneficiary, providing all documentation and conditions stated in the L/C are met.

Bill of Exchange	A written obligation to pay at Sight or at some specific future date a sum certain, to the Drawee.
Drawee	The person or company requiring payment.
Acceptance	The act of signing the Bill of Exchange accepting responsibility for the debt. Once a bill is accepted there is no defence in law against non-payment.
Acceptor	The person or company acknowledging the debt.
Documents against Payment (D/P)	Documents granting Title to the goods will be handed to the Buyer upon payment of the Bill of Exchange.
Documents against Acceptance (D/A)	Documents will be handed to the Buyer upon acceptance of the Bill of Exchange for payment at some future specified date.

### **General Terms**

H.M.C&E. Her Majesty's Customs and Excise Department i.e. UK CUSTOMS

ICC International Chambers of Commerce

### **PERIOD ENTRY**

This is a concession allowed by HMC&E after auditing the importer's computer software. It allows the importer to make monthly returns to HMC&E of all imports made within the period.

### **LOCAL IMPORT**

The local office (relative to the DC into which the 'control' merchandise will be delivered receives notice of the contents and time and date of delivery. If HMC&E wish to inspect the cargo they will attend the DC site at the time of arrival. If they do not appear the merchandise is deemed "cleared" for customs purposes.