

FACTORY GATE PRICING

Retail logistics is undergoing change in the form of a move by a number of major grocer/retailers toward Factory Gate Pricing (FGP). FGP means that the major grocer/retailers will undertake primary distribution from suppliers to regional distribution centres (rdc), as well as secondary distribution from rdcs to stores, i.e., all of the product supply chain.

This is a strategic change, not just a tactical step and has been described as the next revolution in logistics.

FGP or 'ex-works' pricing, is not a new phenomenon, it has been the standard procedure in some sectors, e.g. fashion, automotive parts, for many years. WALMART, in the US for instance, manage up to 80% of non-food purchases as 'ex-works'.

The wider introduction of this concept into grocer/retail logistics in UK is based upon a belief that reduced costs and increased supply chain control and visibility can be achieved.

The FGP initiative in the UK is new in the grocery/retail sector and particularly where it includes the major food retailers, and has taken many suppliers by surprise in the speed of its uptake and the lack of consultation. Tesco now have more than 55% of suppliers on an 'ex-works' basis and are confident of substantial further progress.

Supply chains throughout the major grocer/retailers are largely the same in their logistic structure. Generally, when there is structural change in one company the remainder swiftly adopt the same strategic and operational processes. Historically, therefore, it is entirely likely that all the other grocer/retailers will follow a similar FGP strategy as that adopted by Tesco. Indeed many, such as Sainsbury, are already doing so. Consequently, FGP is likely to become the benchmark for grocer/retail logistics.

The move to FGP has some merit for grocer/retail logistics in that they will be able to:

- Reduce product cost and inventory
- Achieve supply chain visibility and control in vehicle planning, scheduling and utilisation through enterprise compatible systems throughout the product supply chain.
- Reduce waiting time at supply and delivery locations.
- Decrease empty running through backhaul capacity.

- Improve vehicle performance in time, load and distance.
- Increase product visibility through the supply chain, IT interface, POS information, RDIF etc.
- Utilise buying power and supply chain knowledge in ‘partnership’ negotiation.
- Enhance company position on environmental sustainability.

The move also begs the question of how suppliers may react to the change. Many will welcome the release from the difficulty of delivering to rdc's.

A reduced product price, however, leaves a new sales price. One major supplier has calculated that if FGP were to be fully implemented by all of their retailer customers, then the potential market impact could be a perceived market place sales reduction of up to 5%. Understanding all buyer costs can give the retail buyer significant power. This may mean that suppliers, in turn, move to a policy of FGP using current outbound transport.

Primarily any impact will only concern those companies that are suppliers to grocer/retailer suppliers. However, since this sector has a tendency to establish logistic trends, it is likely that in time FGP will become more widely accepted and should be considered accordingly.

However, there may be some possible drawbacks to the FGP theory. It has taken Tesco some time to get to its strategic decision on FGP and during the gestation period a number of factors have become apparent that may limit the strategy.

A combination of the Working Time Directive for mobile workers, a major shortage of drivers, increasing journey time uncertainty through congestion and a multitude of other factors are set to significantly increase the cost of road transport. At the same time a number of grocer/retailers have invested in larger and fewer rdc's or ‘fulfilment factories’ that achieve economies of scale in inventory but mean increased transport distance.