Haute Performance

Member of the advancy network

Logistics Promise and the Customer Value Proposition

May 2022

Abstract

The *Customer Value Proposition* (CVP) is at the heart of the supplier-client relationship and represents the sum of expected benefits (or expected value) that a customer places on a product or service. It, therefore, can describe a product's actual performance versus the competition and can be derived from the "4 Marketing P's". The P's describe four value quadrants of product attributes that make it more desirable to customers. While the Product, the Price and Promotion often receive ample attention, the Place does usually not enjoy the same level of priority. This paper highlights the importance of the place, which we refer to as the service promise to the customer.

Figure 1: *The 4 Marketing P's: Reasons for Disconnect*

In our experience, not all aspects of the Customer Value Proposition are treated as a primary commercial change driver

This logistics promise or service level, as part of the CVP, is usually manifested in the company's Customer Contract, Service Charter, Pricing Booklet or Ts and Cs and represents the supplier's service level contract to customers. It outlines how fast different products or order sizes are delivered and therefore anchors the customer order behaviour and the business's expectations thereof. Thus, the CVP plays a critical role in structuring the logistics and supply-chain process.

When designing the CVP and service promises, logistics managers are pulled into different directions; Customers often want smaller and more frequent deliveries while the business aims for lower logistics costs – associated with larger and less frequent deliveries. The CVP is the tool and contract defining the agreed compromise by both parties. However, the CVP also represents the opportunity to survey and understand the customers' problems. Additionally, logistics efficiencies can be unlocked by defining and segmenting customers with similar logistics requirements, enabling the business to streamline its logistics operations.

The CVP can also be seen as the necessary first step of a network design, as it outlines both the logistics and customer requirements. The development involves both external and internal stakeholders, and, thus, there is a potential to add value for both sides. This value is unlocked by understanding the customer's needs and wants (their problem) and what it takes to serve them most effectively. Therefore, a focused CVP can drive down logistics costs, bolster customer loyalty and attract new potential markets through competitive offerings – with a significant impact on the bottom line.

A well-structured logistics promise as part of the CVP can often increase sales and profits along with market share. Haute Performance was able to consistently assist our clients to realise top-line sales growth (of 3 to 5%), and reduce transport costs (of circa 15%), while also delivering key non-financial benefits.

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Glossary

CVP	–	Customer Value Proposition
DC	–	Distribution Centre
FMCG	–	Fast Moving Consumer Goods
FTL	–	Full Truck Loads
MOQ	–	Minimum Order Quantity (units)
MOS	–	Minimum Order Size (weight)
MOV	–	Minimum Order Value
NDD	–	Nominated Delivery Day
NOD	–	Nominated Order Day
OTIF	–	On Time and In Full Delivery Rate
POS	–	Point of Sale
TAT	–	Truck Turn Around Time

Introduction

Keeping on top of the CVP and, thus, tracking and responding to evolving customer requirements is not simple. Therefore, the customer relationship often erodes over time. The resulting misalignment arises when specific order patterns of different customer channels, types or industries are not or no longer accommodated in the service promise.

In the case of a severe misalignment resulting in the loss of commercial influence and operational inefficiencies, organisations should conduct a full redesign of the service parameters and the promise to the customer. Different customer channels and segments often have different requirements regarding the *Lead Time*, *Minimum Order Value, Quantity or Size* (MOV, -Q, & -S) and *On-Time & In-Full* (OTIF) delivery rates.

A customer value proposition is not rigid but should be constantly evolving alongside the customers it serves. The business must be agile enough to learn, adapt and evolve its offering accordingly

When Haute Performance redesigned the CVP for a multinational Building Material Supplier in South Africa, they faced the following challenges:

- Retail chains demanded daily deliveries of smaller drops as head offices drove down inventory and working capital
- This trend was spilling over to less sophisticated players such as specialised retailers and distributors who placed larger orders historically, while still enjoying bulk discounts
- Lastly, contractors and converters required delivery of large quantities at specific dates far in the future with no tolerance for incomplete or late deliveries

There must be a clear understanding when it comes to service requirements: there is no "one size fits all"

Businesses need to consciously establish logistic-focused parameters in the CVP. It is crucial to understand the internal supply-chain constraints and processes as well as the external customer preferences and competitor offerings. By aligning the CVP to these constraints and preferences, cost reductions can be achieved whilst increasing customer loyalty through reliable and tailored service levels and a streamlined logistics network.

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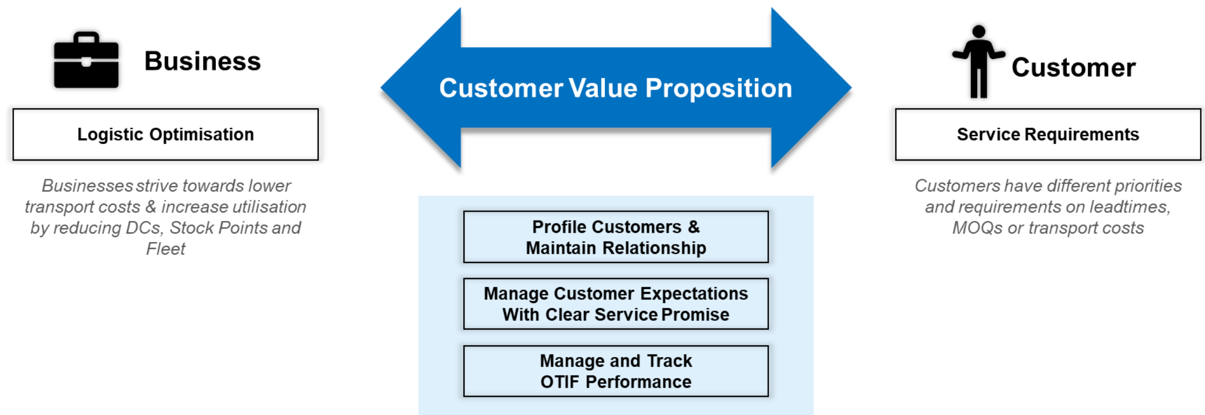

Figure 2: *Context of Customer Value Proposition*

CVP as Commercial Booster

The outlined service promise (with the key levers MOQ and Leadtime) informs the supply chain design. Haute Performance succeeded in past assignments in reducing the inherent supply chain inefficiencies aligning the clients' systems with the targeted outcomes and achieving top and bottom-line growth.

It is critical to understand the potential of the CVP to arbitrate between cost savings, customer loyalty and marketing opportunity

As the CVP allows the business to position itself in the value chain, it must be certain of the space it wants to play in – further up or down in the value chain – and how much it wants to capture. When redesigning the CVP, careful consideration should be applied when changing any of the levers, as changes could result in unintentional volume shifts from one segment in the value chain to another, i.e., from a distributor to a retail chain.

An effective CVP allows the business to realise the value in two ways

- *offer more competitive leadtimes with better on-shelf availability*
- *reinvest transport savings in lower delivery charges, thus driving up price-elastic sales*

Incentivising order sizes through the CVP enables the business to partially control the customer order behaviour. In our experience, customers are receptive to mutually beneficial scenarios, where a reduced price (or lead time) is exchanged for a larger order volume. This allows to unlock value for both the customer and the business.

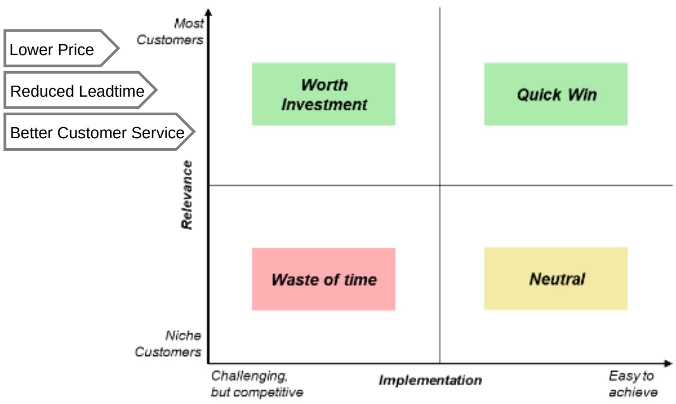

Figure 3: *Risk-Reward Value Proposition*
Ref: Adapted from The House of Marketing (2020)

The risk-reward matrix identifies each potential "scenario" that should be considered in the design of the CVP. The most effective and highest potential options should be targeted first: Quick Wins and Worthy investments.

Businesses are rarely able to be the best on every front and must choose their competitive niche – which must be reflected in their CVP. The parameters that give the business a competitive edge must be identified first to understand the overall CVP offering. However, we often found disconnects within the interpretation of the *As-Is* service positioning (see Figure 4 below) and in the understanding of the *Where-To* positioning.

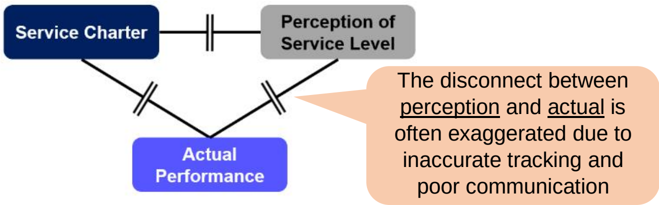

Figure 4: *Understanding the Disconnect*

In an environment where the CVP is not front-of-mind, a degradation of the *As-Is* service performance often occurs over time. This leads to a disconnect between the <u>service promise</u>, the <u>perceived service level</u>, and the <u>actual service level</u>. Due to this disconnect, there is not *one* clear understanding of the service level, and the promise has become ambiguous or distrusted.

- CVP is not communicated to clients
- Break-down in the supply-chain
  - Demand/Production planning
  - Stock Management at Warehouses
  - Issues in order capturing & processing
  - Inefficient transport
- Poor communication in times where CVP promise cannot be adhered to
- Inability to stick to the CVP (from both the customer and manufacturer) allows scope for degradation of its value

Figure 5: *Reasons for Disconnect*

To avoid future degradation, it is imperative to review the CVP regularly and to remind customers of the MOQ and service levels. Then by ensuring that the service promises are reliably and consistently met, the business builds customer trust and loyalty.

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Customer Segmentation

Customers with similar requirements are assigned to CVP Target Groups. There are, of course, various ways to focus a CVP, but the most effective way we found, is by segmenting by *Customer Channels* first. Varying channels often have vastly different ordering and logistic requirements. Consequently, the most challenging part of this exercise is to determine which customer segments have similar logistic requirements. Other common approaches are to align customers that:

- Request delivery to *Distribution Centre* (DC) vs *Point of Sale* (POS)
- *Order Full Truck Loads* (FTL) vs full pallets vs single cases or units
- *Have Nominated Delivery Date* (NDD) vs flexible delivery dates
- Have similar product baskets, or
- Are situated in similar areas (distance from the plant)

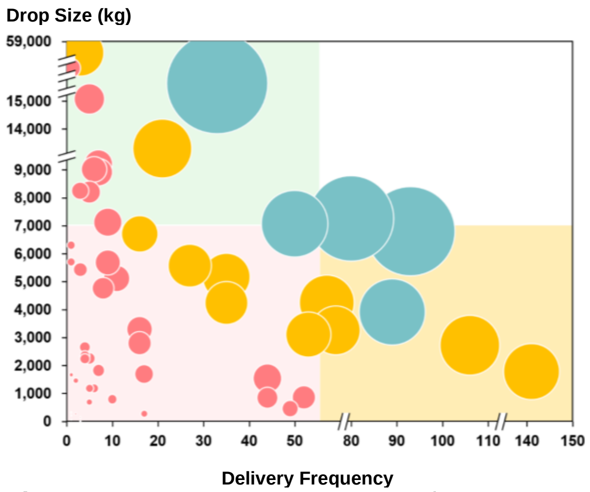

Figure 6: *Customer Segmentation*

A compromise between the internal requirements and customer expectations must be found. At Haute Performance, we target these insights by going straight to the source through a series of focussed customer and internal interviews, asking the right people the right questions.

Managing these interactions, especially with external customers, can be challenging to steer away from superfluous "complaining" without appearing rude or disinterested. One method that assisted our clients in achieving this separation is through interviews guided by an external consultant. The advantage of handling the interview through an external partner is that it allows for more objective responses that are not clouded by either defensiveness or politeness. However, there are benefits in including business representatives such as KAMs in these sessions as they have a familiarity with the customer and the perception that an internal party can more realistically affect change, among other softer client-relationship factors.

It is imperative for the service promise to be as tailored to the individual client as possible, while not "over-differentiating" the service offerings

Identifying the right people both internally and externally can be challenging. When selecting customers for interviews, primary consideration should be given to the "money-makers". The key contributors to revenues must be offered a seemingly tailor-made service. However, a representative sample must be taken including the smaller customers, customers from peripheral regions, or with unusual delivery or order requirements. Customers from every channel should be considered in the sample to ensure that the company gets the input of their complete customer base and their respective opinions. Once the business has established a true reflection of both the internal and external perspectives, decisions can be made to apply the Pareto principle and drive change where it is most effective within the system.

Customer interviews are a great opportunity to test your service offering against competitors and to get a sense of where the business's service promise stands within the market. It allows businesses to see where they fall behind, or where they are leading the charge. By understanding the competitor CVPs the business is able to position itself with a competitive edge, without having to push too far.

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Balancing Between Incentives and MOQs

After considering the potential benefits of appropriately targeting the CVP to specific channels with shared logistic requirements, it is important to set the metrics specific to each of those channels. The two most pivotal levers are the Minimum Order Size (MOQ, -V, or -S) and Lead time(s). These primary drivers support other secondary parameters that logistics managers need to keep in mind like Yard Turn-Around-Times (TAT), Order Cut-Off times, and Backorder Processes, amongst others.

We found the biggest channel differentiator for retailers is whether deliveries are destined for DCs versus Point of Sale (POS). Generally, DC deliveries are larger and more consistent, often composing a full truck and full pallets. POS deliveries usually vary more in terms of frequency and scale, and also tend to be far smaller. Thus, POS deliveries call for a different logistic service offering. When tailoring the MOQs and Lead times appropriately to each channel, value can be unlocked. The business can affect customer order behaviour either through incentives or MOQs.

Incentives

The decision to incentivise preferred customer order behaviour is often better received by the customer than imposing MOQs, as it offers autonomy and control over their ordering process. Higher volume customers are either offered a better price or a shorter lead time, (or a combination of both). The customer is allowed to order in whatever fashion they wish, as the resulting costs are mirrored in the price scale; this method is known as a *Logistic Rebate* and can similarly be applied in the lead time parameter design. There are several ways to build an efficient lead time system: For instance, a Nominated Delivery Day (NDD) enables easier route, load and milk run planning for the business.

The logistic rebate model enables the customer to have more flexibility in the order behaviour, but also, when suitably modelled, shifts the cost of service to the customer. The cost-modelling in establishing any rebate-type system is essential, as the order behaviour that it induces is complex. There are many ways to approach a logistics rebate (i.e., volume, growth, retention, product mix, ship & debit, price masking, etc.) to favourably influence customers' order behaviour.

MOQs

Positioning a limitation metric is the other end of the spectrum. By instilling strict MOQs, customers are required to order above a certain quantity, value, or size. The MOQ model promises a fixed lead time for orders that meet the MOQ level and an extended lead-time for those orders that do not. This method results in more regular order patterns and has a "smoothing effect" on demand, production, and stock planning. Lead times can be further refined with specific MOQs for respective logistic parameters such as distance, channel, or customer priority.

Before setting MOQs, it is essential to have clarity on the volumetrics and the various configurations in which these products can be delivered. Many companies struggle to maintain an accurate *Product Masterfile* and *Transport Matrix*. All stakeholders in the order-to-delivery process must understand what quantities collectively make an MOQ or truckload order as well as benefits from co-loading, for instance, "light-on-heavy", maximising both weight and volume per delivery.

The principle governing both approaches is similar – incentivising bigger orders and less frequent deliveries – the manner through which this incentivisation is achieved differs.

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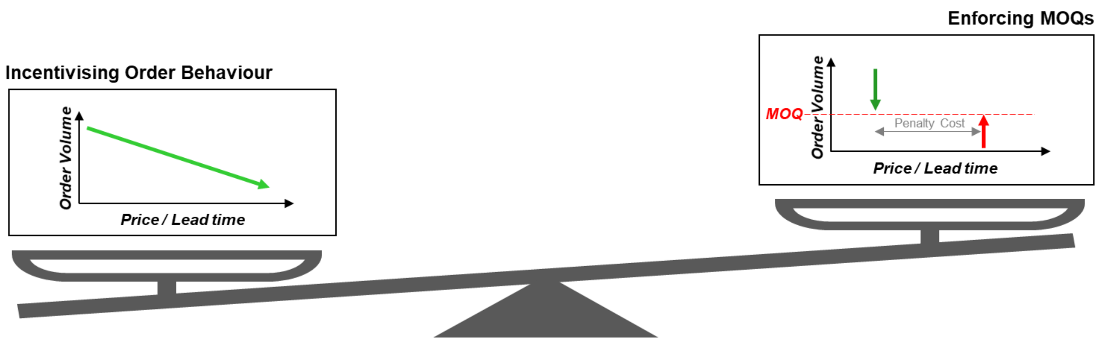

Figure 7: *The CVP Balancing Act*

Importance of Monitoring

Perhaps the most critical success factor of a CVP transformation is the consistency of delivery, according to promise. To ensure consistency it is vital to track and measure performance, and most companies measure "OTIF" – On Time In Full. However, in our experience, the internal perspective of performance is often misaligned with the customers' perception.

Before discussing why this misalignment exists, the OTIF itself should be defined as it can be measured at different levels. For example, for an order of 10 lines and 10 items (100 units total), if 99 units are delivered on time the OTIF would be:

- 0% at *Order Level*,
- 90% at *Order Line Level*, and
- 99% at *Order Line-Item Level*

Measuring OTIF at Order Level is a binary failure record and only if the full order was delivered on time marks a correct delivery. This is the strictest measure and is usually not practical in logistics. On the other hand, measuring OTIF at the Order Line-Item level is, in a similar way, not practical. Customers usually reject this measuring level as it is the most lenient one. Therefore, we recommend that OTIF should be measured at *Order Line Level* representing a fair compromise between the two extremes.

The other main reason for the disconnect between customers and businesses arises through the internal system administration of the order capturing process. Date misalignments that lead to inaccurate lead time tracking (See Figure 8 below) are frequent with many of our clients. It is dangerous territory when that break in communication exists, and the client is unhappy whereas the business "achieves" compliance to the promised service level. Despite the trend towards further automation and integration utilising EDI, Order Mapping Software, and ePOD, OTIF measurements can be inaccurate.

Capturing the wrong date in the wrong field, capturing a date early or late (compared to cut-off time), or even just not updating the order completion with the true delivery date (at point of delivery) can lead to significant lead time tracking misalignment. Unless accurately tracked, it becomes a "he-said-she-said" game of

1. What and when the customer ordered
2. What the call centre heard and when it was recorded
3. What and when transport received the order

Once the measurement has been aligned, it is essential to keep a finger on the pulse through constant monitoring to understand the OTIF levels and customer satisfaction. Constant tracking also allows the business to flag problems such as out-of-stocks or clients abusing the system. This helps the business to remedy issues before significant costs or reputational implications are incurred.

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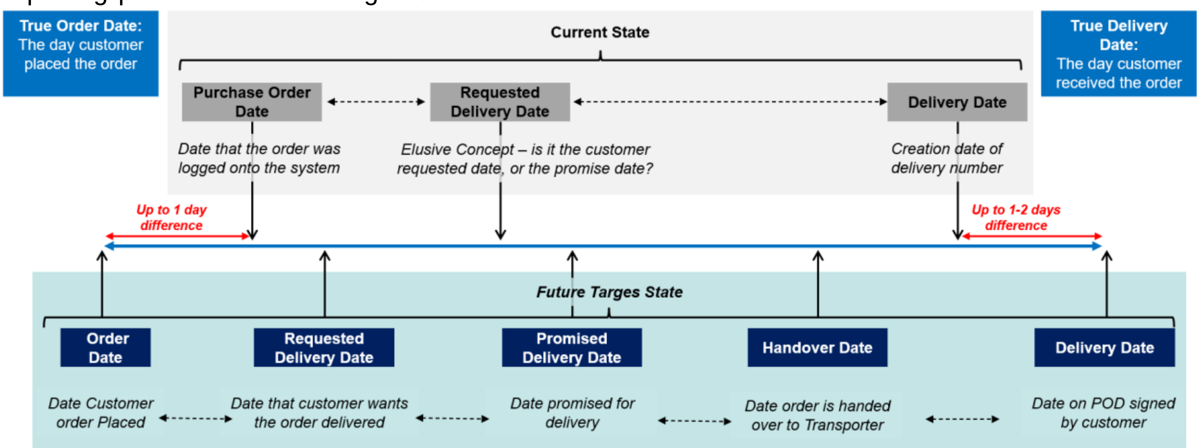

Figure 8: *Common Date Tracking Errors – Client Study Example*

Managing Change

One of the most challenging aspects of introducing a new CVP is change management, both internally and externally. This is especially true when it is perceived that the change is less favourable to the individual parties. It is for this key reason that businesses fall into out-of-date legacy behaviours to avoid the difficulties that come with change.

Unmet expectations and customer dissatisfaction can occur when the service promise is not clearly stated or understood

The essential tool to ensure successful change management is communication – the benefits of the change must be communicated to each of the stakeholders. Therefore the new CVP must be appropriately written, easy to understand and void of any potential ambiguity that could lead to different interpretations. For this purpose, simplicity is favoured (See Figure 9 which outlines the do's for writing a CVP).

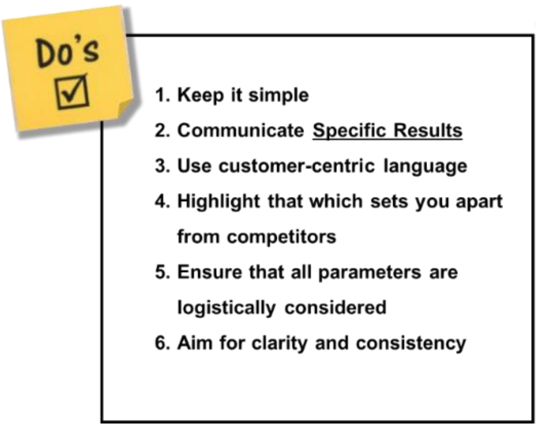

Figure 9: *CVP – Ease of Understanding*

In terms of getting buy-in from customers, both the style in which the CVP is written, and how it is communicated are important. The CVP document deserves dedicated communication with each key account by the respective KAM and must be continuously referenced thereafter. This continuous communication ensures that the business is keeping the finger on the pulse and drifts to old habits can be avoided. Additionally, the CVP parameters should be easily accessible to all at any time on an online platform.

The other key driver to successful change is to avoid communication without action: Action plans must be followed by immediate implementation thereof. The punch and effectiveness of communication of changes are lost if changes are not directly visible to stakeholders. This action comes with a very important caveat: change can only be implemented and socialised effectively if it is sustainable. Changing something as business critical as a CVP cannot occur overnight and planning the change management is imperative.

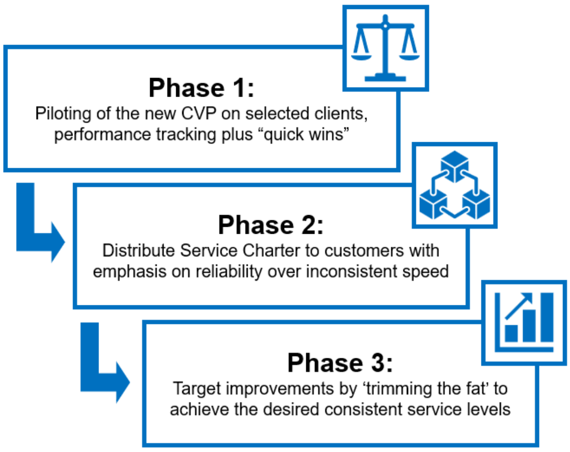

Figure 10: *Staging the Implementation of the Customer Value Proposition*

Whatever change is promised must above all else be sustainable. A business cannot demand CVP adherence from its customers without strict adherence itself. This was reaffirmed in our experience as customers repeatedly voiced that they favour reliability over speed. Our phased approach (see above) takes this feedback to heart:

Phase 1: In this pilot phase, the CVP is tested, and performance is tracked on a small sample of "priority clients". The second phase will only commence once a consistent service level is achieved. The measurement of such is now trustworthy as it is aligned with customer experience (set cut-off times, etc,) and delivers accurate performance measurements. This phase should be viewed as an opportunity to align internally before socialising the new service promise with other customers externally.

Phase 2: The second phase is the real test, where commitments are challenged against the inefficiencies of diverse customer groups and customers resisting change. It is critical to have all internal stakeholders on board and aligned with the cause in this phase.

We advise communicating a "buffered" CVP to customers initially with some slack built-in. By doing so, the business allows itself "some scope" for mistakes, but also "room to improve" as it will always be easier to implement change that is viewed as beneficial rather than detrimental to the customer.

Phase 3: The final phase is for "trimming the fat": Once reliability and trust have been established in the system and the CVP promise (internally and externally), the opportunity for optimisation arrives. This phase is focused on the removal of buffers on lead times, MOQ requirements or later cut-off times to increase competitiveness.

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Key Enablers

Once MOQs and lead times are established three key supporting metrics will help to maintain an efficient supply chain.

The first of these is to define the *Order Cut-off Time*. This is typically around midday and determines whether the order is processed on the same or the next day in the system. Strictly adhering to this stipulation takes some strain off the order-processing team and helps the business to build and consolidate loads more efficiently in good time before delivery.

Similarly, to ensure a smooth-running delivery system, expected *Truck Turn Around Times* (TAT) should be benchmarked and stipulated (internally for the loading time and externally for deliveries to clients as well as for client collections from the plant). By stipulating TATs, the business protects itself from any delays at the customer end that could drive inefficiencies and have knock-on effects on service levels to other customers. In a well-defined and neatly contracted system, these inefficiencies could be priced into the delivered price to the customer.

The last, and possibly most contentious, of the enablers is Backorder Processing. Backorders are often an under-discussed issue, as ideally, there should not be any. Backorders are most often a result of 'out of stocks' or incorrect deliveries. In our experience, it is necessary to define the process that is suitable for both customers and the business. Customers are most often dismayed for two reasons based on poor communication:

- uncommunicated delays
- uncommunicated short deliveries

When customers understand the process followed for an out-of-stock or any other backorder, and the process is adhered to as communicated, the actual occurrences of backorders become less important.

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Final Word

It is an untold reality that in many businesses across many industries, the CVP is not effectively managed. As a result, businesses struggle with misaligned service promises which can cause inefficiencies in the supply chain and/or customer frustration. Furthermore, the breakdown in the CVP can be worsened by kneejerk reactions.

The overarching objective of a tailored service promise is to create a fair and consistent service level and to track the business' performance against it. Wherever Haute Performance has helped clients, they realised both top and bottom-line improvements. As availability on the shelf increased (because of improved OTIF), companies experienced a 3-5% year on year improvement (adjusted for external factors). Our clients also benefitted from a reduction in transport costs through better utilisation and trip coordination.

The roadmap to achieve these benefits starts with understanding the existing service offering and the disconnect between current and promised service levels as well as the customer perception thereof.

One of the biggest reasons for customer dissatisfaction and disloyalty is **unmet customer expectations.** By identifying customer requirements, order patterns, channels and industries, businesses can tailor their service promise accordingly. By incentivising specific order behaviour, the CVP is the easiest way to assume control of the customer relationship.

As customers repeatedly voice that they favour reliability over speed, our approach is focused on establishing reliability and trust, both internally and externally. Only after stakeholders trust the service promise, can optimisation and tweaking be undertaken. After completing all three phases, benefits such as cost reductions and customer loyalty are accrued for companies through meeting their needs better and more reliably than before. Importantly, consistency allows businesses to lower logistics costs and attract new markets.

The Customer Value Proposition shall constantly evolve alongside the customers it serves. A business must react to changing customer preferences to avoid misalignment. Therefore, the business must be agile enough to learn, adapt and evolve its offering accordingly.

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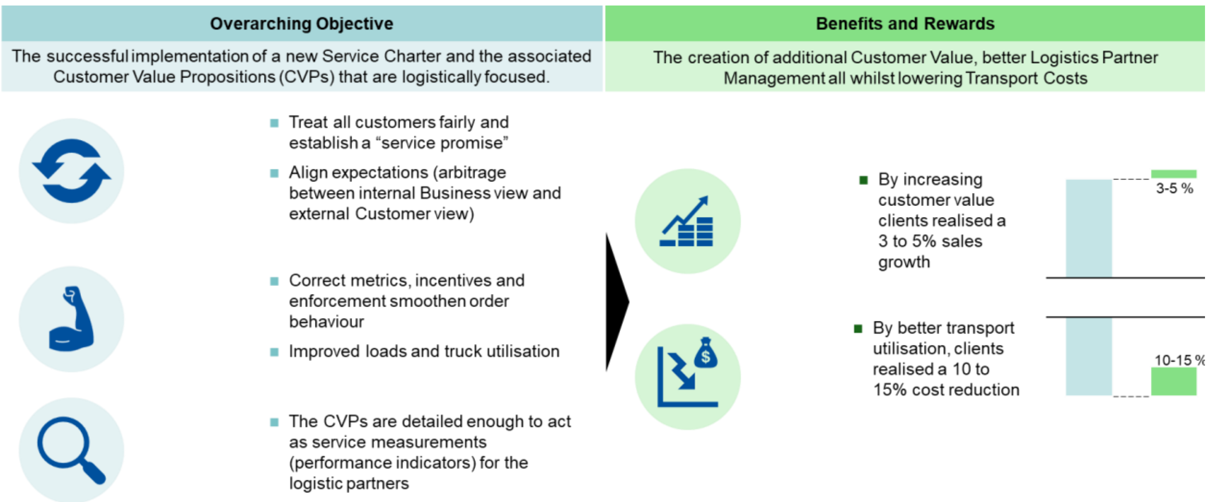

Figure 11: *Summary of CVP Objectives, Benefits, and Rewards*