

Doing More with Less: Making Inventory More Productive



Over the past year, many retailers have worked to better balance inventory levels with lower sales expectations so as not to be caught with the excess inventories of last fall, inventories that required dramatic markdowns and liquidation efforts. The recession has further forced many retailers to make drastic inventory reductions but, unfortunately, these cutbacks were reactive, not strategic in nature. Some retailers delayed or cancelled orders and made across-the-board reductions that don't allow for significant variability in demand across categories and regions. These retailers now risk having too little of the right product while still facing the dilemma of what to do with too much of the wrong product.

In general, retailers are reluctant to make significant bets on winning merchandise, i.e., buying deeply into a product that becomes a hot seller, because such bets often come at the expense of other critical elements in their assortments. This hedge against being overbought can result in a sparse-looking store and can impact consumers' perceptions. As Saks CEO Stephen Sadove recently told a reporter, "If you have too little merchandise, it won't feel like you're in business." Those who still have too much inventory must decide between transferring excess inventory from store to store—resulting in higher logistics and labor costs—or once again facing the margin impact of heavy markdowns on the bottom line.

In any case, if across-the-board inventory reductions don't help retailers get to the root of deep-seated inventory management problems, how can retailers turn around such inventory problems quickly? How can retailers make changes that will lay the foundation for solving greater, long-term inventory issues? By focusing on in-season management and just a few key areas, retailers can see rapid and substantial results that can fuel the momentum to make more fundamental changes in future seasons.

How have some retailers substantially reduced inventories, boosted margins and cut millions of dollars in costs without reducing their ability to respond to unpredictable and uneven spurts in demand across their stores? By learning how to do more with less.

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Getting the Right Information Flow and Metrics

Improving in-season inventory positions requires getting merchandising, planning, supply chain, marketing and other functions to work off “one version of the truth.” It also means aligning these teams around the same critical metrics.

Numerous functions play a role in a retailer’s inventory management—not just the planning or supply chain functions. These functions may have quite different information on what’s selling (or not) and why, when product is due to arrive and when and where it is needed. This lack of common information leads to errant plans and disjointed operations, or simply put, the wrong inventory in the wrong place at the wrong time. For example, supply chain managers may not get a demand plan from the merchants. Supply chain managers must then rely on prior shipment data to create their own

forecasts to develop labor and shipping plans. If they over- or underestimate, the supply chain performance can become erratic, with product arriving at stores too early or too late.

In placing orders with vendors, buyers may base decisions not on what’s actually selling in the stores, but rather on what their distribution centers are shipping to stores. That risks over- or underestimating true demand and starving or flooding stores with inventory.

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Possible Inventory Flows

Across the range of inventory flow options, shifting to the right whenever possible helps offset margin and inventory risk

Higher Risk

Lower Risk

	One Shipment	Push-Push	Hold & Flow	DC Replenishment	Pack & Flow	Replenishment
Description	<ul style="list-style-type: none"> Vendor unit commitments are made pre-season A single shipment is delivered from the vendor, 100% is allocated to stores 	<ul style="list-style-type: none"> Vendor unit commitments are made pre-season A single shipment (split into an initial set and a reserve) is received from the vendor Initial set is shipped to the stores immediately Held products are pushed to stores after initial sales 	<ul style="list-style-type: none"> Vendor unit commitments are made pre-season A single shipment (split into an initial set and a reserve) is received from the vendor Initial set is shipped to the stores immediately After a period of selling (~3 weeks), held products are pushed to stores 	<ul style="list-style-type: none"> Vendor unit commitments are made pre-season Total commitment is shipped to the DC at beginning of each season all at once or staggered Multiple shipments are made from the DC to the stores based on individual store needs 	<ul style="list-style-type: none"> Vendor unit commitments are made pre-season The initial shipment is sent at the beginning of the selling life Subsequent shipments are delivered from the vendor monthly or every other month, while the remaining units are held at the factory/vendor DC 	<ul style="list-style-type: none"> Vendor unit commitments are made pre-season and in-season Multiple shipments are received from the vendor throughout a season Multiple shipments are made to the stores based on individual store needs
Candidate Characteristics	<ul style="list-style-type: none"> Short product lifecycle (less than 6 weeks of full price selling) All purchase and allocation commitments happen pre-season 	<ul style="list-style-type: none"> Low demand predictability Seasonal items with shorter lifecycles High velocity and initial sell-through (within first 2 weeks) 	<ul style="list-style-type: none"> Moderate to low demand predictability Seasonal items with greater than an 8 week lifecycle Initial set makes up less than 80% of total season commitment 	<ul style="list-style-type: none"> Moderate demand predictability Medium to long product cycle (lives at full price for more than a season) 	<ul style="list-style-type: none"> Moderate demand predictability Medium to long product lifecycle 	<ul style="list-style-type: none"> Moderate to high predictability Long product lifecycle May have high size intensity May have high in-stock importance

One example of this disconnect was recently observed at a regional grocer. They had two different roles: store replenishment analysts, who were evaluated on store in-stock percentages, and warehouse replenishment analysts, who were evaluated on warehouse in-stock levels. Rather than rating both roles on a common metric (i.e., store service levels), the grocer chose to measure each on their respective service levels. This resulted in excessive store inventory levels in some cases, as store analysts tried to achieve as high an in-stock percentage as possible, while in other cases warehouse replenishment personnel would “discontinue” certain items that had availability issues so as to not impact the warehouse service level (their own metric), while store service levels—and sales—suffered.

Getting the Right Combination of Product Flow Paths

Inventory problems can worsen when a retailer has only one or two product flow paths. All products go through these paths regardless of whether they have short or long shelf lives or whether they are domestically or foreign sourced. The result can be that some products are delivered too slowly, creating shortages and lost sales opportunities, while others are shipped too quickly, building up inventory in the wrong place (the back room of the store).

Retailers need to develop the capability to support several efficient flow paths aligned to product type and need. For example, one flow path might be suitable to short-shelf-life products ordered frequently, while another could be devoted to low-velocity but high-value and/or difficult-to-forecast products, and yet a third could be configured for predictable consumables that can be reordered from vendors and cross-docked efficiently to stores. The cost and processing times of each flow path must be understood, as well as the operational implications of adding flow paths (i.e., the time and cost it will take to adjust the company’s current supply chain).

The case of teen fashion retailer Aéropostale shows how common information and multiple flow paths can dramatically improve performance. The \$1.8 billion chain has been one of the few retail successes in the recession. To be sure, much of their success is from designing and developing apparel that teenagers embrace, but another reason is their inventory management capabilities. Aéro’s merchandising planners, store, distribution center and other supply chain managers all draw on the same information to get product to market. This cross-functional team has common data and consistent measures. They share an integrated calendar, which ensures Aéro’s 885 stores, three distribution centers and supply chain function know exactly what items the merchants have bought and when to expect them. Aéro has also expanded the number of paths through which their products flow to customers, from three to eight. While most retailers’ comp-store sales were down in 2009, Aéro’s were up 12% through June, while they continued to maintain their best-in-class inventory performance. In fact, their three-year turn average from 2006–2008 was 10% higher than their 2003–2005 average.

Getting Product in the Right Amounts to the Right Place at the Right Time

At the highest level, a retailer’s products are segregated into two categories: longer-life products that can be replenished throughout their selling life, and products with a shorter selling life that must be allocated to stores in limited quantities. Managing inventory for these two categories requires very different capabilities and tools, and usually people excel at one or the other, but rarely at both.

Most retailers have long-established replenishment processes and tools. Those who have high levels of surplus inventory or shortages need to revisit the core parameters that drive their replenishment systems. Not only should they examine the logic of today’s replenishment decisions on order cycles, order quantities and presentation quantities (both minimums and maximums), but they should study other parameters as well, such as lead time, lead time variance, demand variance, case pack and service level, which are often set with blanket policies or left with default system values. When these parameters are unmanaged or out of alignment, even the most intelligent automated systems will drive inventory performance in the wrong direction.

Even if demand forecasts are largely on target, a retailer can still wind up with too much product in one region and too little in another, while even greater inventory imbalances can occur within a region at the individual store level. Over the longer term, they will need leading assortment and allocation technology that can give buyers and planners a much richer picture of the variability of demand by region and by store. This will increase the chances that product ends up in the correct amounts, in the right place and at the right time. However, implementing such software—installing it, making the requisite changes in people’s jobs and training them on the technology—can take a year or longer. A retailer without such software has to do something else to improve inventory management.

The first changes should be made to base allocation practices, where changes to techniques and analysis can provide a quick ROI while requiring little capital outlay. Many chains cling to flat or banded allocations, where the same quantity goes to similar-sized stores or groups based on volume, square footage or other factors with no subsequent formal review of the results achieved. As there are bound to be variations in demand by region or individual store, such practices create inventory problems. Instead, retailers should base allocation on both the sales history and the inventory performance of each store. Most chains have the software to do this but too often aren’t fully tapping the functionality of their allocation tools.

The case of a large regional supermarket chain shows how just a few enhancements in allocation and replenishment can markedly improve inventory positions. The faltering economy and increasing competition from national chains led to a number of inventory problems for this company. The management team increased markdowns and reallocated inventory across stores, which in turn increased shipping costs and squeezed margins.

To address this dire predicament, the grocery chain management restructured their general merchandising function, designing new allocation and replenishment processes. They created a new role—inventory analyst—to improve these processes. The analyst used sophisticated spreadsheet-based allocation tools developed in-house that collected data from the company’s existing information systems. For seasonal products (which constituted about 20% of business), the company shifted from flat or banded to store-specific allocations. More importantly, they began measuring the effectiveness of allocation decisions. With some easy-to-implement changes to their business intelligence software, they began analyzing the effectiveness of individual allocations by comparing initial allocation quantities by store to post-allocation selling patterns. Using this analysis, they were able to critically review the logic and parameters driving allocation with the goal of improving the future allocation decision-making process. Planners and inventory analysts collaborated on initial allocation decisions and analyzed subsequent successes and failures without resorting to finger-pointing. Similarly, replenishment activities were scrutinized and revamped. Previously, replenishment decisions were owned by an analyst in the company’s supply chain operations, who was responsible for replenishment orders and monitoring inventory levels for a wide range of product categories across a group of stores. This analyst had insufficient time to understand

inventory problems in any one category. Other functions controlled inventory management decisions of non-replenishment items. As a result, each product category had no end-to-end inventory visibility or accountability. Even worse, the supply chain analyst made replenishment decisions based on service levels at the distribution centers, not at the store level.

The grocery chain had the new inventory analysts manage replenishment as well as allocation. Each analyst was made responsible for about 10 categories. They became deeply familiar with the nuances of each category in terms of demand and supply. The company also designed a process that ensured that inventory levels at every store were visible to the replenishment analyst, and that they were factored into the WOS and vendor orders.

The impact of these changes was quick and significant. In just a few months, the new allocation processes and tools boosted gross margins by more than 300 basis points, and the company is on track to reduce warehouse inventory levels by \$7 million in just the first year of the program.

Short-Term Moves Boost Short-Term Results and Lay the Foundation for Long-Term Gains

The end of the current recession has proven hard to predict, so retailers would be wise to remain highly conservative about their inventories. Further, even when the end to the current economic challenges occurs, it is unlikely that inventory performance expectations will revert to pre-recession levels. After all, if a retailer can achieve pre-recession sales levels with dramatically improved inventory performance, why wouldn’t they? Taking immediate corrective actions on in-season allocation, replenishment and flow practices can make marked improvements, help retailers get the most productivity out of the inventory they have and position them for continued success in the future.

