

Kurt Salmon ✨



RETAIL INDUSTRY INSIGHTS

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# Maximising Inventory Efficiency

# Retail Operational Excellence

There is nothing like a recession to focus the mind on releasing cash by reducing inventory. Kurt Salmon analysis confirms that most retailers carry between 20% to 40% surplus inventory. The good news is that customer service improves when a stock turn improvement programme is properly implemented. A win-win solution, but what are the key elements of an effective stock reduction plan?

## Inventory efficiency to build competitive advantage – retail operational excellence by Kurt Salmon

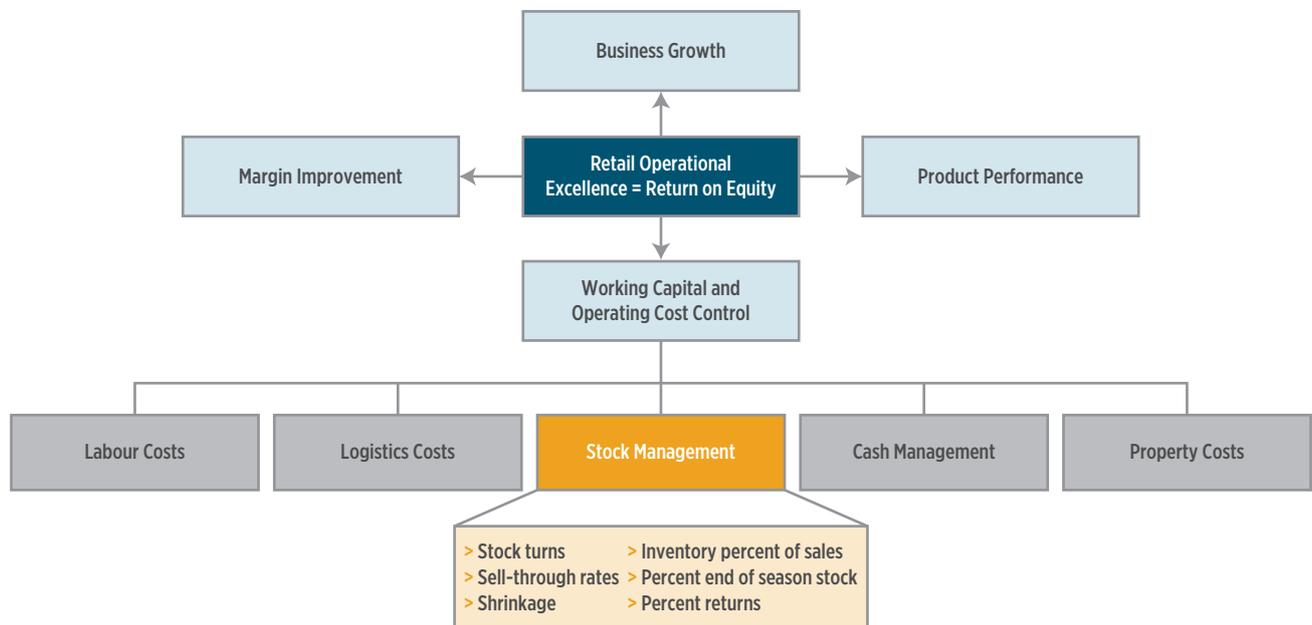
Retail operational excellence is the combination of four drivers: business growth, margin improvement, product performance and working capital and cost control. In periods of downturn, when business growth opportunities

are limited and initiatives on margin or product performance appear to take longer in delivering business benefits, retailers tend to concentrate on working capital and cost optimisation to sustain operational efficiency.

In retail, where inventory typically accounts for 10% of sales, optimising working capital is an important component of performance improvement. The six key indicators of inventory performance improvement are stock turns, sell-through rates, shrink rates, inventory as a percentage of sales, percentage end of season's stock and percentage returns.

Kurt Salmon, the leading global management consulting firm specialising in the retail and consumer goods sectors, has developed a complete set of approaches and tools to assist retailers in their inventory efficiency initiatives.

**EXHIBIT 1: Inventory Indicators Within Kurt Salmon's Retail Operational Excellence Model**



## Maximising inventory efficiency through three areas of supply chain optimisation:

Retailers can maximise inventory efficiency through three types of initiatives :

- » Making sure the product is right—this is about assortment rationalisation, which has a positive impact on stock levels, but does not primarily focus on them.
- » Making sure the delivery channels are correct—this is about product flow optimisation, which directly addresses the inventory question, but is generally considered as a long-term initiative.
- » Making sure stock management is performed according to best practices—this is inventory management excellence, an initiative which directly targets the skills, art and science of managing pushed and pulled inventory, from the initial forecast to the management of over-stocks and returns.

### 1. THE RIGHT PRODUCT—Assortment Rationalisation

Inventory efficiency is not the only benefit of assortment rationalisation. In fact, it is often a side effect. In its entirety, Kurt Salmon defines assortment rationalisation as a process and set of analytical tools used to understand past performance, providing directional feedback on the optimal assortment breadth. Our approach helps identify opportunities to improve the assortment that will drive sales, margin, and inventory turns. Rationalised assortments are simpler to manage and result in consolidated demand, a reduced number of options, and therefore in an opportunity to reduce overall stocks.

Kurt Salmon's assortment rationalisation toolkit combines a selection of tools and data analyses to understand the true opportunities for rationalising the product offer, comparing

retailers' performance to industry benchmarks. This method results in sales revenue increases, improved availability and decreased markdown, which also drives the reduction of obsolete inventory.

Our approach uses deep assortment analysis coupled with product and consumer knowledge. Examples of analysis include:

- » Identifying and understanding **SKU proliferation**, to reduce the number of poor or underperforming products adding to stock management complexity.
- » Understanding which products and segments of the range **drive sales and profitability**, in an attempt to focus working capital on the most profitable segments and refine service-level requirements.
- » Comparing actual **size selling to store receipts**, in order to avoid over-stocking the wrong product declinations, generating end-of-season stock.

### 2. THE RIGHT CHANNEL—Product Flow Optimisation

Assuming assortments are optimised, the next task is to identify the best product flow network for each product and supplier. Maximising inventory efficiency is about moving categories away from the DC stock channel to an alternative zero-stock channel, such as cross-docking, bulk-pick-to-zero or direct-to-store.

Channel selection is based on four key questions which need to be regularly revisited:

- » **How predictable is the product's demand forecast?**  
Demand is more predictable for products with stable demand patterns and large frequent order quantities (as opposed to erratic demand and small quantities). Zero-stock channels can be preferred for predictable demand patterns, whereas DC stock should be kept for products where demand patterns are unpredictable.

“The Kurt Salmon team was very good to work with. They really knew what they were doing and challenged us, while still managing to work within our culture and values. They showed honesty and integrity, putting our interests first.”

Head of Retail HR, UK top 5 grocer

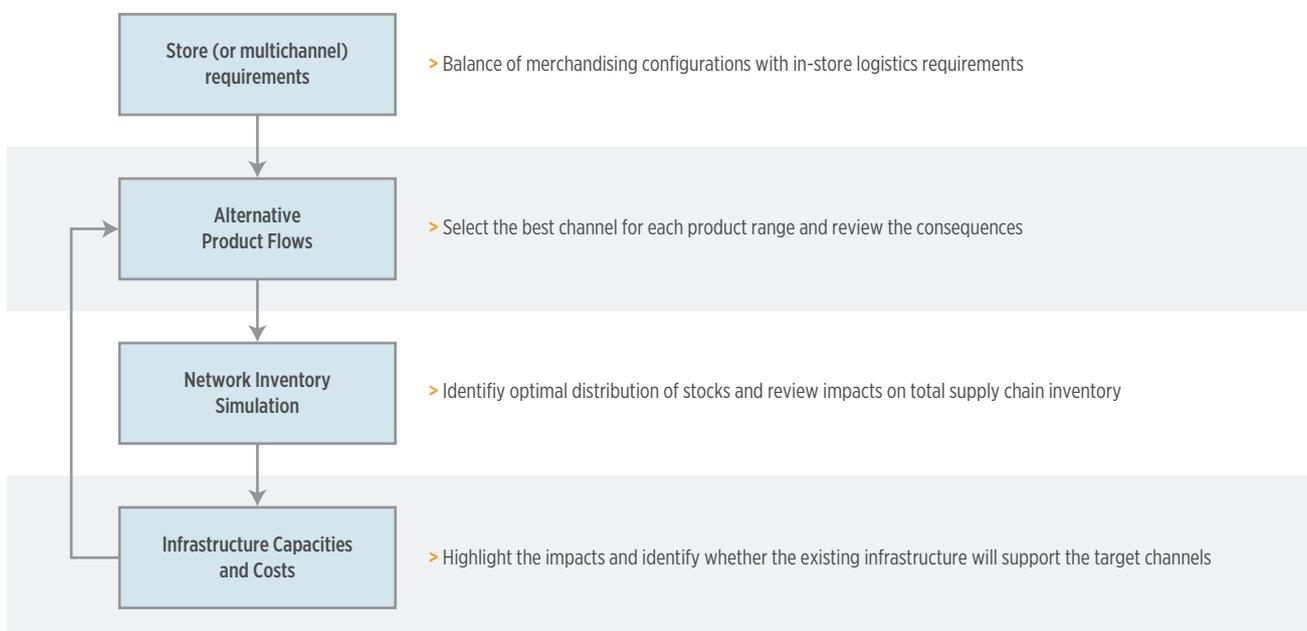
- » **How critical is product availability in store?** Not all products are high-margin, traffic-builder products that must be NOOS (Never Out-Of-Stock). Low margin, easily substitutable products do not require the same level of availability, and therefore do not require the safety of a DC stock.
- » **How reactive are my suppliers?** Supplier reactivity depends on their localisation, and on the reliability of their internal operations. With reactive suppliers, retailers are safer and can adopt a zero-stock channel. Less reactive suppliers will drive retailers to keep stock in their DC as a safety measure against their poor delivery capabilities.

- » **How much stock can I hold in store?** The appropriate inventory level in store depends on the product's size and value, as well as the demand for that product. Retailers should choose to hold more stock in the DC for products which are too large or too expensive to be stored in store in large quantities. For others, the combination of the inventory in store and the delivery frequency could allow them to reduce DC stock.

The combination of the four answers enables the best delivery channel to be identified.

We have developed an approach and a series of tools to simulate and identify the best product flow network for a retail chain.

## EXHIBIT 2: Product Flow Optimisation



Our approach takes a 360° view of all supply chain variables affecting product flow management:

- » Store (or multichannel) requirements—allocation and replenishment
- » Alternative product flows
- » Network (supplier, consolidation centres, DCs and stores) inventory
- » Infrastructure capacities and costs.

Product flow optimisation is an enabler for mid- to long-term decisions, generally used to design or validate major supply chain network infrastructure choices, or select the location of a distribution centre or logistics partner. However, quick action and fast results are possible by working in two areas:

- » **Increasing the flexibility of channel allocation.** Best-in-class retailers have flexible channels, which they adapt depending on the product life cycle. Typically, retailers would deliver a newly launched product using cross-docking, and then switch to the DC stock channel for replenishment.
- » **Revisiting channel allocation by looking at four key questions.** Best-in-class have excellent forecasting capabilities and a clear strategy regarding product availability requirements. They develop advanced supply chain partnerships with their key suppliers, and maximise both the use of store space and delivery frequency.

### EXHIBIT 3: Maximising Inventory Efficiency

|   |                      |   |
|---|----------------------|---|
| <b>PUSH</b><br><br>(based on forecast)                  | <b>Best Practice</b> | <ul style="list-style-type: none"> <li>&gt; Collaboration between central merchandiser, stores and suppliers to best evaluate pushed quantities</li> <li>&gt; Joint calendar for each promotion and new product introduction</li> <li>&gt; Exact match between execution and the agreed plan in terms of quantities and lead-time</li> </ul>  |
|   | <b>Key Questions</b> | <ul style="list-style-type: none"> <li>&gt; Who is the best source? Stores, central merchandisers, or suppliers? How should these sources be best leveraged?</li> <li>&gt; What flexibility should be given to stores? e.g. Can they refuse a central promotion?</li> <li>&gt; What is the best method for synchronising information sharing with suppliers and stores (i.e. align demand visibility with manufacturing plan)?</li> </ul> |
| <b>PULL</b><br><br>(based on sales)                     | <b>Best Practice</b> | <ul style="list-style-type: none"> <li>&gt; Automated calculation of replenishment quantities based on sales results</li> <li>&gt; Advanced replenishment algorithms allowing flexible use of various calculation methods</li> <li>&gt; Optimisation based on multiple criteria (transportation costs, service, stock levels)</li> </ul>  |
|   | <b>Key Questions</b> | <ul style="list-style-type: none"> <li>&gt; What is the process for validating suggested order quantities? Is the store involved?</li> <li>&gt; How and who decides the replenishment parameters? Should the stores be involved?</li> </ul>   |
| <b>PUSH/PULL</b><br><br>(varies with product lifecycle) | <b>Best Practice</b> | <ul style="list-style-type: none"> <li>&gt; Flexible model which allows the hold and flow model to be managed dynamically and to be aligned with the product life-cycle</li> </ul>  |
|   | <b>Key Questions</b> | <ul style="list-style-type: none"> <li>&gt; When do we have enough visibility of sales to switch from push to pull?</li> <li>&gt; How can alerts be generated to indicate moving from pull to push (markdowns and liquidation)?</li> <li>&gt; Who makes these decisions? What is the role of the store vs. the central merchandising department?</li> </ul>   |

### 3. EXCELLENCE IN INVENTORY MANAGEMENT

Once product assortments and delivery channels are defined, retailers can bring inventory efficiency further by adopting best-in-class inventory management practices. Kurt Salmon's complete inventory management toolkit, assesses retailer performance and develops quick-win improvement plans in five key areas:

- » **Forecast accuracy.** Understanding the accuracy of the demand forecast can help drive accurate replenishment decisions. A comparison of the original product forecast versus daily or weekly sales results can help determine the accuracy of the demand forecast and opportunities to improve supply chain performance.
- » **Optimisation of visual presentation.** Determining the optimal initial fixture fill quantity that satisfies demand and is visually appealing to the customer is essential. Weekly store-level unit sales, presentation standards, assortment levels, and zone store assignments are taken as inputs to identify opportunities to increase or decrease store inventory to better fulfill demand.
- » **Optimisation of hold and flow model.** The objective in this area is to define the optimal push/pull/push strategy for all relevant product categories. The simulation uses historical and forecasted weekly sales and receipts by style or colour, safety stock variables, and presentation standards by store cluster to best calibrate the quantities and timing of the push/pull/push process.
- » **Allocation effectiveness.** The objective in this area is to align store-based allocation quantities against actual demand. Our simulation uses style-level allocation units or store-level receipt units, and daily or weekly store-level unit sales, to evaluate the allocation variance achieved. We also simulate the result that would have been achieved with alternative allocation techniques, in order to identify the most appropriate one.

- » **Markdown effectiveness.** The objective in this area is to improve the efficiency of markdowns per category by optimising markdown timing and amounts. The analysis uses daily or weekly store-level unit sales, markdown rates and timing to analyse the sales and stock impact of markdowns and their timing, in order to best adjust markdown practices.

#### EXAMPLES OF PROJECT RESULTS:

- > End-to-end supply chain re-engineering for global top 20 retailer: Improved underlying operating model by over \$1 billion annually, including reducing over 160 DCs to fewer than 25 and implementing a new buying model.
- > Supply chain change programme, optimizing balance of availability, stock-holding and costs: Identified 30% stock reduction in stores and DCs.
- > End-to-end supply chain programme—new product flows, inventory optimisation and gap analysis with existing infrastructure: Increased availability by 9%, £41m stock reduction, ability to manage 3-year growth without investment, reduced DC costs.
- > Range rationalisation, including workshops and assortment optimisation model resulting in action plans to improve range profitability: 10% to 25% reduction in SKU's, increased range profitability, 8% increase in margin with maintained sales.

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## KURT SALMON

Kurt Salmon is the leading global management consulting firm specialising in the retail and consumer products industries. We leverage our unparalleled industry expertise to help business leaders make strategic, operational and technology decisions that achieve tangible and transformative results.

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