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## Retail's Shorter Shelf Life

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With recession's lessons still fresh, retailers turn to 3PLs and sophisticated processes to balance supply and demand

In 2007, home improvement retailer Lowe's already was intent on improving inventory processes that would reverberate throughout global supply chains when the worst recession in decades hit a year later.

It turned to Whirlpool, focusing on the appliance maker's manufacturing capabilities and limitations as both companies sought to understand each other's target inventory levels and the importance of planning for new products relative to inventory.

To get there, the two giants integrated collaborative planning forecasting and replenishment, and sales and operations planning processes to improve inventory management. For the first time, supply chain staffs at each company became actively involved with sales and merchandising departments, collaborating to develop a single set of aligned forecasts and sales plans.

Three years later, the companies' overall inventory costs are down 5 percent, unit sales are up

12 percent and the percentage of on-time shipments has improved by 3 points.

The Lowe's-Whirlpool relationship is a prime example of how retailers and their suppliers can use sophisticated supply chain tools to formulate logistics strategies that fall straight to the bottom line.

Although the retail sector isn't as tumultuous as last year, when retailers frantically restocked inventories that were slashed during the recession, the shaky economy, depressed consumer spending and the lessons learned from the recession mean inventory management is more important than ever as retailers limp toward what is shaping up as another less-than-stellar holiday selling season.

To cope with uncertainty, more retailers and their third-party logistics providers are using sophisticated CPFR, S&OP and vendor managed inventory processes to improve that inventory management.

Many of the nation's largest retailers have tamped down the optimism they felt in the spring in the face of economic signals that are mixed at best, said Casey Chroust, executive vice president of retail operations for the Retail Industry Leaders Association, a Washington-based trade association that counts nine of the top 10 U.S. retailers as members.

While individual retailers such as Home Depot, TJX, Apple and Macy's are reporting strong sales numbers, stagnant employment growth is spooking the industry in general. "It's one of our key economic indicators," Chroust said. "If people don't have jobs, they can't shop."

In June, the nonprofit Conference Board reported that consumer confidence fell to its lowest level since November 2010 before recovering slightly in July. The current levels are "very problematic" for the retail industry, Chroust said.

Retailers are likely to be cautious until economic signals improve. They will err on the side of too little inventory rather than too much as they aggressively manage bottom-line numbers. "If you can't grow the top line, you have to shrink the bottom line, and inventory management is a crucial part of that," Chroust said.

Retail supply chain costs have shrunk over the years as retailers streamline distribution networks, shift from truck to rail, explore new sourcing options and implement postponement and other inventory management strategies.

Some retailers are responding to the growth of private label merchandising, which accounts for as much as 35 percent of stocked items in some stores, by taking control of transportation at overseas sourcing points, a process called "disintermediation."

In an ongoing push to lower inventory costs, CFOs and other financial executives have joined their supply chain peers in cross-functional inventory management teams throughout the retailing industry, said Keith Goldsmith, senior vice president of business development for Netherlands-based global 3PL CEVA Logistics.

"The makeup of the people at the table has changed as there is an insatiable appetite to do more with less," he said.

With consumer confidence flagging, retailers are willing to compromise on service levels or cost of sales to save on inventory costs. To mitigate the impact of those types of decisions, they are using postponement and dynamic allocation strategies to allocate real inventory against in-transit inventory that may not even be on the books yet.

CEVA, for example, operates a staging area in Miami for a computer retailer where laptops

bound for sale in South America are assembled and packaged according to regional language and technical requirements.

“The trend to using inventory in transit as real inventory is at an all-time high,” Goldsmith said. “It takes a lot of inventory out of the supply chain and reduces transit times.”

Retailers also are tightening their distribution networks. Most of CEVA’s retail clients are shutting some of the their big-box distribution centers and going to a two-tier distribution model, with big-box DCs on the East and West coasts and smaller, shared regional warehouses and forward stocking facilities scattered throughout the country for faster-moving goods.

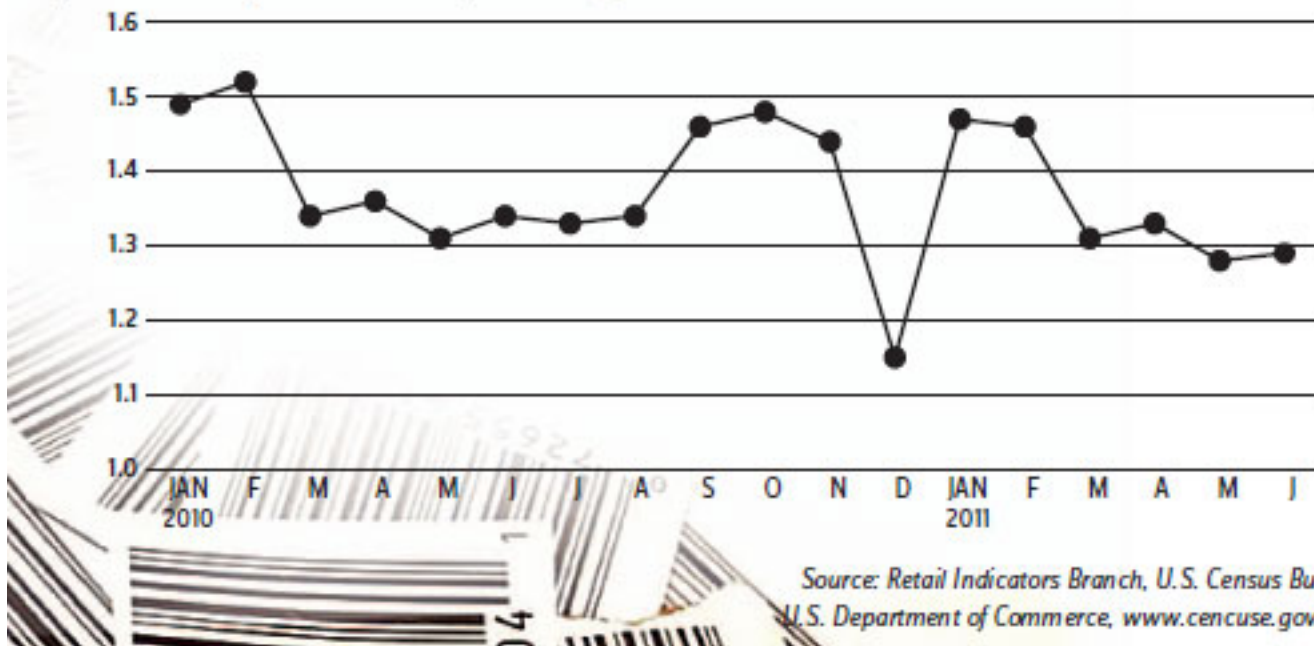
“No one builds big DCs anymore,” Goldsmith said. “Scaling up is easy, but scaling down is harder.”

CEVA has a number of clients who turned to logistics outsourcing in 2008 and 2009 to slash costs as the recession kicked in. That business generally came about not by retail supply chain leaders pushing for more efficient warehouse management, but by financial executives looking to get their companies out of the warehousing business entirely.

Innovative strategies for managing inventory these days are driven less by thought leadership than by companies having been burned by high fixed costs. Retailers recognize they need scalability and flexibility to avoid the risks of too little or too much inventory.

## U.S. RETAIL INVENTORY TO SALES RATIO

*Retail sales increased 9.1 percent in June from a year earlier, but fell 0.9 percent from May. Inventories rose 5 percent year-over-year, but were down 0.3 percent from May. The sales-to-inventory ratio – which reflects the number of months it would take to deplete inventories at the current rate of sales – of 1.29 inched up from 1.28 in May, but was down from 1.34 a year earlier.*



By leveraging scale, 3PLs play a key role in numerous inventory management strategies. Some of CEVA’s major automotive clients are mingling freight, a practice they wouldn’t have considered a decade ago. Most automotive parts are shipped to big-box import DCs and from there to forward warehouses, which among automakers are often in close proximity. Mingling freight seems like an obvious solution, but it ran contrary to long-entrenched business practices

in the mature automotive sector.

These semi-dedicated distribution models make eminent sense in an industry where density is one of the keys to lowering inventory and shipping costs.

"The best way to do that is to marry up with competitors," Goldsmith said. "You can't do that alone, but you can with a 3PL."

CEVA also has taken over the leases or purchased outright a number of DCs owned by retail clients looking to shed assets. In most cases, CEVA added the warehouse employees to its own payroll. CEVA operates the warehouses as sophisticated multiclient facilities that are fully leased and offer a variety of value-added services, a big improvement from the 30 to 40 percent capacities the retailers had.

Inventory management is the reason retailers either sink or swim, said Stephanie Miles, senior vice president of commercial services for Management Dynamics, an East Rutherford, N.J.-based provider of global trade management solutions. "Financial analysts will tell you the way to understand which stock to buy or avoid is the ratio between inventory and sales."

Retail sales in June increased 9.1 percent year-over-year, but were off almost 1 percent from May. With inventories rising 5 percent year-over-year, the June retail sales-to-inventory ratio — reflecting the number of months it would take to deplete inventories at the current rate of sales — was 1.29, up marginally from May's 1.28, but down dramatically from the year's high of 1.52 in February.

3PLs have a big role to play in the inventory management process. Management Dynamics' key differentiators include its global trade content and services, which allow retailers to optimize sourcing by identifying the best places to source, understand all relevant trade rules and develop strategies to optimize duty and tax rates. Another key service is providing the linkages between trading partners to support lean inventory strategies. "We give retailers visibility that extends far beyond inbound shipments," Miles said.

Retailers are responding to weak consumer spending and low inventory turnover with lots of sales promotions, a risky strategy that could imperil the bottom line, said Ralph Cox, a principal with Tompkins Associates, a Raleigh, N.C., global supply chain services and consulting firm. "It's a hard place to be in right now," he said.

While most major retailers have sophisticated inventory planning processes in place, many smaller retailers, including some with as many as 500 stores, have little or no forecasting or advanced inventory processes. "There are many good solid product people who have never had any training on the science of inventory management," Cox said. "They know their categories very well, but run their inventories on judgment and instinct."

Retailers are definitely avoiding risks and shying away from excess inventory, especially slower-moving goods, said Shaun Phillips, global product manager for supply chain planning for Infor, one of the world's largest providers of business software. "Everything is so volatile now," he said. "A lost sale is not what it used to be."

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